(e) *Examples.* The following examples illustrate the provisions of this section. Assume, for purposes of these examples, that the obligation assumed by the corporation does not reduce the shareholder's basis in the corporate stock under section 358(d). The examples are as follows:

Example 1. Transfer of partnership property to corporation. In 2004, in an exchange to which section 351(a) applies, PRS, a cash basis taxpayer, transfers $2,000,000 cash to Corporation X, also a cash basis taxpayer, in exchange for Corporation X shares and the assumption by Corporation X of $1,000,000 of accounts payable incurred by PRS. At the time of the exchange, PRS has two partners, A, a 90% partner, who has a $2,000,000 basis in the PRS interest, and B, a 10% partner, who has a $50,000 basis in the PRS interest. Assume that, under section 358(h)(1), PRS's basis in the Corporation X stock is reduced by the accounts payable assumed by Corporation X ($1,000,000). Under paragraph (b) of this section, A's and B's bases in PRS must be reduced, but not below zero, by their respective shares of the section 358(h)(1) basis reduction. If either partner's share of the section 358(h)(1) basis reduction exceeds the partner's basis in the partnership interest, then the partner recognizes gain equal to the excess. A's share of the section 358(h) basis reduction is $900,000 (90% of $1,000,000). Therefore, A's basis in the PRS interest is reduced to $1,100,000 ($2,000,000 − $900,000). B's share of the section 358(h) basis reduction is $100,000 (10% of $1,000,000). Because B's share of the section 358(h) basis reduction ($100,000) exceeds B's basis in the PRS interest ($50,000), B's basis in the PRS interest is reduced to $0 and B recognizes $50,000 of gain. This gain is treated as gain from the sale of the PRS interest.

Example 2. Transfer of partnership interest to corporation. In 2004, A contributes undeveloped land with a value and basis of $4,000,000 in exchange for a 50% interest in PRS and an assumption by PRS of $2,000,000 of pension liabilities from a separate business that A conducts. A's basis in the PRS interest immediately after the contribution is A's basis in the land, $4,000,000, unreduced by the amount of the pension liabilities. PRS develops the land as a landfill. Before PRS has economically performed with respect to the pension liabilities, A transfers A's interest in PRS to Corporation X, in an exchange to which section 351 applies. At the time of the exchange, the value of A's PRS interest is $2,000,000, A's basis in PRS is $4,000,000, and A has no share of partnership liabilities other than the pension liabilities. For purposes of applying section 358(h), the transfer of the PRS interest to Corporation X is treated as a transfer to Corporation X of A's share of PRS assets and an assumption by Corporation X of A's share of the pension liabilities of PRS ($2,000,000). Because the pension liabilities were not assumed by PRS from A in an exchange in which the trade or business associated with the liability was transferred to PRS, the transfer of the PRS interest to Corporation X is not excepted from section 358(h) under section 358(h)(2). See paragraph (c) of this section. Under section 358(h), A's basis in the Corporation X stock is reduced by the $2,000,000 of pension liabilities.

(f) *Effective date.* This section applies to assumptions of liabilities by a corporation occurring on or after June 24, 2003.

[T.D. 9207, 70 FR 30341, May 26, 2005]

EFFECTS ON CORPORATION

§ 1.361–1 Nonrecognition of gain or loss to corporations.

Section 361 provides the general rule that no gain or loss shall be recognized if a corporation, a party to a reorganization, exchanges property in pursuance of the plan of reorganization solely for stock or securities in another corporation, a party to the reorganization. This provision includes only stock and securities received in connection with a reorganization defined in section 368(a). It also includes nonvoting stock and securities in a corporation, a party to a reorganization, received in a transaction to which section 368(a)(1)(C) is applicable only by reason of section 368(a)(2)(B).

§ 1.362–1 Basis to corporations.

(a) *In general.* Section 362 provides, as a general rule, that if property was acquired on or after June 22, 1954, by a corporation (1) in connection with a transaction to which section 351 (relating to transfer of property to corporation controlled by transferor) applies, (2) as paid-in surplus or as a contribution to capital, or (3) in connection with a reorganization to which part III, subchapter C, chapter 1 of the Code applies, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain recognized to the transferor on such transfer. (See also §1.362–2.) See §1.460–4(k)(3)(iv)(B)(*2*) for rules relating to adjustments to the basis of certain contracts accounted for using a long-term contract method of accounting

that are acquired in certain transfers described in section 351 and certain reorganizations described in section 368(a).

(b) *Exceptions.* (1) In the case of a plan of reorganization adopted after October 22, 1968, section 362 does not apply if the property acquired in connection with such reorganization consists of stock or securities in a corporation a party to the reorganization, unless acquired by the exchange of stock or securities of the transferee (or of a corporation which is in control of the transferee) as the consideration in whole or in part for the transfer.

(2) In the case of a plan of reorganization adopted before October 23, 1968, section 362 does not apply if the property acquired in connection with such reorganization consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee (or, in the case of transactions occurring after December 31, 1963, of a corporation which is in control of the transferee) as the consideration in whole or in part for the transfer. The term *issuance of stock or securities* includes any transfer of stock or securities, including stock or securities which were purchased or were acquired as a contribution to capital.

[T.D. 7422, 41 FR 26569, June 28, 1976, as amended by T.D. 8995, 67 FR 34605, May 15, 2002]

§ 1.362–2 Certain contributions to capital.

The following regulations shall be used in the application of section 362(c):

(a) Property deemed to be acquired with contributed money shall be that property, if any, the acquisition of which was the purpose motivating the contribution;

(b) In the case of an excess of the amount of money contributed over the cost of the property deemed to be acquired with such money (as defined in paragraph (a) of this section) such excess shall be applied to the reduction of the basis (but not below zero) of other properties held by the corporation, on the last day of the 12-month period beginning on the day the contribution is received, in the following order—

(1) All property of a character subject to an allowance for depreciation (not including any properties as to which a deduction for amortization is allowable),

(2) Property with respect to which a deduction for amortization is allowable,

(3) Property with respect to which a deduction for depletion is allowable under section 611 but not under section 613, and

(4) All other remaining properties.

The reduction of the basis of each of the properties within each of the above categories shall be made in proportion to the relative bases of such properties.

(c) With the consent of the Commissioner, the taxpayer may, however, have the basis of the various units of property within a particular category adjusted in a manner different from the general rule set forth in paragraph (b) of this section. Variations from such rule may, for example, involve adjusting the basis of only certain units of the taxpayer's property within a given category. A request for variations from the general rule should be filed by the taxpayer with its return for the taxable year for which the transfer of the property has occurred.

§ 1.362–3 Basis of importation property acquired in loss importation transaction.

(a) *Purpose.* The purpose of section 362(e)(1) and this section is to modify the application of section 362(a) (section 351 transfers, contributions to capital, or paid-in surplus) and section 362(b) (reorganizations) to prevent a corporation (Acquiring) from importing a net built-in loss in a transaction described in either section. See paragraph (c) of this section for definitions of terms used in this section.

(b) *Basis determinations under this section*—(1) *Basis of importation property received in loss importation transaction.* Notwithstanding the general rules of section 362(a) and (b), Acquiring's basis in importation property (as defined in paragraph (c)(2) of this section) acquired in a loss importation transaction (as defined in paragraph (c)(3) of this section) is equal to the value of the property immediately after the transaction.

(2) *Adjustment to basis of subsidiary stock in triangular reorganizations.* If a corporation (P) computes its basis in stock of a subsidiary (whether S or T) under §1.358–6 (stock basis in certain triangular reorganizations), P's basis in property treated as acquired by P in §1.358–6(c) is determined under section 362(e)(1) and this section to the extent such property, if actually acquired by P, would be importation property acquired in a loss importation transaction. See §1.358–6(c)(1)(i)(A), (c)(2)(ii)(B), and (c)(3)(i). The subsidiary's basis in the property actually acquired in the transaction is determined under applicable law (including this section), without regard to the amount of any adjustment to P's basis in the subsidiary's stock. Thus, the basis of the property in S's or T's hands may differ from the amount of the adjustment to P's basis in its stock of S or T.

(3) *Acquiring's basis in other property transferred.* In general, Acquiring's basis in property received in a section 362 transaction (as defined in paragraph (c)(1) of this section) that is not determined under section 362(e)(1) and this section is determined under section 362(a) or section 362(b). However, if the transaction is described in section 362(a) (without regard to whether it is also described in any other section), further adjustment may be required under section 362(e)(2). See §1.362–4.

(4) *Other effects of basis determination under this section*—(i) *Determination by reference to transferor's basis.* A determination of basis under this section is a determination by reference to the transferor's basis, including for purposes of sections 1223(2) and 7701(a)(43). However, solely for purposes of applying section 755, a determination of basis under this section is treated as a determination not by reference to the transferor's basis.

(ii) *Not tax-exempt income or noncapital, nondeductible expense.* The application of this section does not give rise to an item treated as tax-exempt income under §1.1502–32(b)(2)(ii) or as a noncapital, nondeductible expense under §1.1502–32(b)(2)(iii).

(iii) *No effect on earnings and profits.* Any determination of basis under this section does not reduce or otherwise affect the calculation of the all earnings and profits amount provided in §1.367(b)–2(d).

(c) *Definitions.* For purposes of this section, the following definitions apply:

(1) *Section 362 transaction.* The term *section 362 transaction* means any transaction described in section 362(a) or in section 362(b).

(2) *Importation property*—(i) *General rule.* The term *importation property* means any property (including separate portions determined under paragraph (d)(4) of this section and separate portions of property tentatively divided under paragraph (e)(2) of this section) with respect to which—

(A) Any gain or loss that would be recognized on its sale by the transferor immediately before the transaction (the transferor's hypothetical sale) would not be subject to tax imposed under any provision of subtitle A of the Internal Revenue Code (federal income tax) (taking into account the provisions of paragraph (d) of this section); and

(B) Any gain or loss that would be recognized on its sale by Acquiring immediately after the transaction (Acquiring's hypothetical sale) would be subject to federal income tax (taking into account the provisions of paragraph (d) of this section).

(ii) *Special rules for applying this paragraph (c)(2).* See paragraph (d) of this section for rules for determining whether gain or loss on a hypothetical sale would be taken into account in determining a federal income tax liability and paragraph (e) of this section for rules applicable when more than one person would take such gain or loss into account.

(3) *Loss importation transaction.* The term *loss importation transaction* means any section 362 transaction in which Acquiring's aggregate basis in all importation property received from all transferors in the transaction would exceed the aggregate value of such property immediately after the transaction. For this purpose, Acquiring's basis in property received is determined without regard to this section or section 362(e)(2).

(4) *Value*—(i) *General rule.* The term *value* means fair market value.

(ii) *Special rule for transfers of partnership interests.* Notwithstanding the general rule in paragraph (c)(4)(i) of this section, when referring to a partnership interest, for purposes of this section, the term *value* means the sum of the cash that Acquiring would receive for the interest, assuming an exchange between a willing buyer and a willing seller (neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts), increased by any §1.752–1 liabilities (as defined in §1.752–1(a)(4)) of the partnership allocated to Acquiring with regard to such transferred interest under section 752 immediately after the transfer to Acquiring. If a partnership has elected under section 754, or if section 743(b) would require a downward basis adjustment to the partnership property, the partnership must apply the rules of §1.743–1 to determine the amount of the basis adjustment to the partnership property.

(d) *Rules for determining whether gain or loss would be taken into account in determining a federal income tax liability*—(1) *General rule.* In general, any gain or loss that would be recognized on a hypothetical sale described in paragraph (c)(2) of this section is considered to be subject to federal income tax if, taking into account all relevant facts and circumstances, such gain or loss would affect or be taken into account in determining the federal income tax liability of the transferor or Acquiring, respectively. This determination is made without regard to whether such person has or would have any actual federal income tax liability for the taxable year of the transaction.

(2) *Look-through rule in the case of certain pass-through entities.* Notwithstanding the general rule in paragraph (d)(1) of this section, the determination of whether any gain or loss on a hypothetical sale would be treated as subject to federal income tax is made by reference to the person that would be required to include such gain or loss in its taxable income if the hypothetical seller is—

(i) A trust treated as owned by its grantors or others (see section 671);

(ii) A partnership (see section 701); or

(iii) An S corporation (see sections 1363 and 1366).

(3) *Controlled foreign corporation (CFC), passive foreign investment company (PFIC).* For purposes of this section, gain or loss that would be recognized by a CFC (as defined in section 957(a)) or a PFIC (as defined in section 1297(a)) is not deemed taken into account in determining a federal income tax liability solely because it could affect an inclusion under section 951(a) or section 1293(a).

(4) *Special rule for debt-financed property subject to section 512.* If property is debt-financed property (as defined in section 514(b)) owned by an organization subject to the unrelated business income tax described in section 511(a)(2) and, as a result, a portion of any gain or loss on a sale of the property would be included in unrelated taxable business income (UBTI) under section 512, such property is treated as divided into separate portions in proportion to the amount of such gain or loss that would be includible in UBTI. The rules of paragraph (e) of this section apply to determine the characterization of such portions (as includible in the determination of a federal income tax liability or not), and the tax treatment and consequences of the transaction in which such portions are transferred.

(5) *Look-through treatment in the case of certain avoidance transactions*—(i) *Application of this paragraph (d)(5).* This paragraph (d)(5) applies if—

(A) The transferor is a domestic entity that is a trust (other than a trust described in paragraph (d)(2)(i) of this section), estate, regulated investment company (as defined in section 851(a)), a real estate investment trust (as defined in section 856(a)), or a cooperative (as described in section 1381); and

(B) The transferor transfers, directly or indirectly, property that was transferred to or acquired by it as part of a plan (whether of transferor, Acquiring, or any other person) to avoid the application of section 362(e)(1) and this section to a section 362 transaction.

(ii) *Effect of application of this paragraph (d)(5).* Notwithstanding paragraph (d)(1) of this section, if a transferor is described in both paragraphs (d)(5)(i)(A) and (B) of this section—

(A) The transferor is treated as though it distributes the proceeds of

the hypothetical sale (which, for this purpose, are presumed to be an amount greater than zero);

(B) To the fullest extent possible under the transferor's organizing instrument, the deemed distribution is treated as made to a distributee or distributees that would not take distributions from the transferor into account in determining a federal income tax liability; and

(C) The determination of whether the gain or loss on the hypothetical sale is treated as subject to federal income tax is made by reference to the deemed distributee or distributees.

(iii) *Tiered entities.* If a deemed distributee is an entity described in paragraph (d)(5)(i)(A) of this section, the determination of whether gain or loss on the hypothetical sale is taken into account in determining a federal income tax liability is made by treating the deemed distributee, and any successive such deemed distributees, as a transferor and applying the rules in paragraphs (d)(5)(i) and (ii) of this section to its deemed distribution (and to all successive deemed distributions), until no deemed distributee or successive deemed distributee is an entity described in paragraph (d)(5)(i)(A) of this section.

(e) *Special rules for gain or loss that would be taken into account by multiple persons*—(1) *In general.* If gain or loss from a disposition of property would be includible in income by more than one person, the property is treated as tentatively divided into separate portions in proportion to the amount of gain or loss recognized with respect to the property that would be allocated to each such person. If an entity's organizing instrument specially allocates gain and loss, the tentative division of property under this paragraph (e) must reflect the manner in which gain or loss on the disposition of such property would be allocated under the terms of the organizing instrument and any applicable rules of law, taking into account the net gain or loss actually recognized by the entity in that tax year.

(2) *Application of section.* The rules of this section apply independently to each tentatively divided portion to determine if the portion is importation property. Each tentatively divided portion that is determined to be importation property is included with all other importation property in the determination of whether the transaction is a loss importation transaction.

(3) *Acquiring's basis in property tentatively divided into separate portions.* Immediately after the application of section 362(e)(1) and this section and before the application of section 362(e)(2), each property treated as tentatively divided into separate portions for purposes of applying section 362(e)(1) and this section ceases to be treated as tentatively divided and Acquiring has a single, undivided basis in such property that is equal to the sum of—

(i) The value of each tentatively divided portion that is importation property, if the transaction is a loss importation transaction; and

(ii) Acquiring's basis in each tentatively divided portion that is not importation property received in a loss importation transaction, as determined under section 362(a) or section 362(b), as applicable, and without regard to any potential application of section 362(e)(2).

(f) *Examples.* The examples in this paragraph (f) illustrate the application of section 362(e)(1) and the provisions of this section. Unless otherwise indicated, the examples use the following nomenclature and assumptions: A and B are U.S. citizens. DC, DC1, and P are domestic corporations that have not elected to be S corporations within the meaning of section 1361(a)(1) and that are not members of a consolidated group. F is a foreign individual. FP is a foreign partnership. FC, FC1, and FC2 are foreign corporations. Unless the facts indicate otherwise, the foreign individuals, corporations, and partnerships are not engaged in a U.S. trade or business, have no U.S. real property interests, and have no other relationships, activities, or interests that would cause them, their shareholders, their partners, or their property to be subject to federal income tax. There is no applicable income tax treaty, all persons' tax years are calendar years, and all persons and transactions are unrelated unless the facts indicate otherwise.

Example 1. Basic application of section. (i) *Section 351 transfer of importation property in a loss importation transaction.* (A) *Facts.* FC owns three assets, A1 (basis $40, value $150), A2 (basis $120, value $30), and A3 (basis $140, value $20). On Date 1, FC transfers A1, A2, and A3 to DC in a transaction to which section 351 applies.

(B) *Importation property.* If FC had sold A1, A2, or A3 immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Further, if DC had sold A1, A2, or A3 immediately after the transaction, DC would take into account any gain or loss recognized on the sale in determining its federal income tax liability. Therefore, A1, A2, and A3 are all importation properties. See paragraph (c)(2) of this section.

(C) *Loss importation transaction.* FC's transfer of A1, A2, and A3 is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's aggregate basis in the importation properties, A1, A2, and A3, would be $300 ($40 + $120 + $140) under section 362(a) and the properties' aggregate value would be $200 ($150 + $30 + $20). Therefore, the importation properties' aggregate basis would exceed their aggregate value and the transaction is a loss importation transaction. See paragraph (c)(3) of this section.

(D) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction.* Because the importation properties, A1, A2, and A3, were transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in A1, A2, and A3 will each be equal to the property's value ($150, $30, and $20, respectively) immediately after the transfer.

(E) *Basis of property received in transaction.* Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section, DC's aggregate basis in the transferred properties would not exceed their aggregate value immediately after the transfer. Therefore, FC does not have a net built-in loss, FC's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to this transaction. DC's bases in A1, A2, and A3, as determined under paragraph (i)(D) of this *Example 1,* are $150, $30, and $20, respectively. Under section 358(a), FC receives the DC stock with a basis of $300 (the sum of FC's bases in A1, A2, and A3 immediately before the exchange).

(ii) *Reorganization.* The facts are the same as in paragraph (i)(A) of this *Example 1* except that, instead of transferring property to DC in a section 351 exchange, FC merges with and into DC in a transaction described in section 368(a)(1)(A). The analysis and results are the same as set forth in paragraphs (i)(B), (C), and (D) of this *Example 1.* However, the analysis in paragraph (i)(E) of this *Example 1* does not apply to these facts because the transaction is not subject to 362(e)(2) and §1.362–4. Under section 358(a), FC's shareholders will take the DC stock with a basis determined by reference to their FC stock basis.

(iii) *FC's property used in U.S. trade or business.* (A) *Facts.* The facts are the same as in paragraph (i)(A) of this *Example 1,* except that FC is engaged in a U.S. trade or business and uses all the properties in that U.S. trade or business. In this case, none of the properties would be importation property because FC would take any gain or loss on the disposition of the properties into account in determining its federal income tax liability. Accordingly, this section does not apply to the transaction.

(B) *Basis of property received in transaction.* Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC's aggregate basis in the transferred properties would be $300 ($40 + $120 + $140) under section 362(a) and the properties' aggregate value immediately after the transfer would be $200 ($150 + $30 + $20). Therefore, FC has a net built-in loss and FC's transfer of A1, A2, and A3 is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), FC's $100 net built-in loss ($300 aggregate basis over $200 aggregate value) would be allocated proportionately (by the amount of built-in loss in each property) to reduce DC's basis in the loss properties, A2 and A3. See §1.362–4. As a result, DC's basis in A2 would be $77.14 ($120 basis under section 362(a) reduced by $42.86, A2's proportionate share of FC's net built-in loss, computed as $90/$210 × $100) and DC's basis in A3 would be $82.86 ($140 basis under section 362(a) reduced by $57.14, A3's proportionate share of FC's net built-in loss, computed as $120/$210 x $100). However, if FC and DC were to elect under section 362(e)(2)(C) to apply the $100 basis reduction to FC's basis in the DC stock received in the transaction, DC's bases in A2 and A3 would remain their section 362(a) bases of $120 and $140, respectively. Under section 362(a), DC's basis in A1 is $40 (irrespective of whether the section 362(e)(2)(C) election is made). If FC and DC do not make a section 362(e)(2)(C) election, FC's basis in the DC stock received in the exchange will be $300; if FC and DC do make the election, FC's basis in the DC stock will be $200 ($300 − $100 net built-in loss). See §1.362–4(b).

Example 2. Multiple transferors. (i) *Facts.* The facts are the same as in paragraph (i)(A) of *Example 1* of this paragraph (f), except that FC only owns A1 (basis $40, value $150) and A2 (basis $120, value $30) and F owns A3 (basis $140, value $20). On Date 1, FC transfers A1 and A2, and F transfers A3, to DC in a single transaction described in section 351.

(ii) *Importation property.* A1 and A2 are importation properties for the reasons set forth in paragraph (i)(B) of *Example 1* of this paragraph (f). A3 is also an importation property because, if F had sold A3 immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability, and, further, if DC had sold A3 immediately after the transaction, DC would take into account any gain or loss recognized on the sale in determining its federal income tax liability.

(iii) *Loss importation transaction.* The transfers by FC and F are a section 362 transaction. The transaction is a loss importation transaction for the reasons set forth in paragraph (i)(C) of *Example 1* of this paragraph (f) (notwithstanding that one of the transferors, FC, did not transfer a net built-in loss). See paragraph (c)(3) of this section.

(iv) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction.* Because the importation properties, A1, A2, and A3, were transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in A1, A2, and A3 will each be equal to the property's value ($150, $30, and $20, respectively) immediately after the transfer.

(v) *Basis of property received in transaction.* Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. The application of section 362(e)(2) is determined separately for each transferor. See §1.362–4(b). Taking into account the application of section 362(e)(1) and this section, neither DC's aggregate basis in FC's properties nor DC's basis in F's property would exceed the properties' respective values immediately after the transaction. Therefore neither FC nor F has a net built-in loss, neither transfer is a loss duplication transaction, and section 362(e)(2) does not apply to either transfer. DC's bases in A1, A2, and A3, as determined under paragraph (iv) of this *Example 2*, are $150, $30, and $20, respectively. Under section 358(a), FC's basis in the DC stock received is $160 ($40 + $120) and F's basis in the DC stock received in the exchange is $140.

Example 3. Transfer of importation and non-importation property. (i) *Facts.* As in paragraph (i) of *Example 2*, FC owns A1 (basis $40, value $150) and A2 (basis $120, value $30), and F owns A3 (basis $140, value $20). In addition, A2 is a U.S. real property interest as defined in section 897(c)(1). On Date 1, FC transfers A1 and A2, and F transfers A3, to DC in a single transaction described in section 351.

(ii) *Importation property.* A1 and A3 are importation properties for the reasons set forth in paragraph (i)(B) of *Example 1* and paragraph (ii) of *Example 2* of this paragraph (f), respectively. However, A2 is not importation property because, if FC had sold A2 immediately before the transaction, FC would take into account any gain or loss recognized on the sale in determining its federal income tax liability.

(iii) *Loss importation transaction.* FC's and F's transfer is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's aggregate basis in the importation properties, A1 and A3, would be $180 ($40 + $140) and the properties' aggregate value would be $170 ($150 + $20) immediately after the transaction. Therefore, the importation properties' aggregate basis would exceed their aggregate value immediately after the transaction, and the transfer is a loss importation transaction.

(iv) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction.* Because the importation properties, A1 and A3, were transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in A1 and in A3 will each be equal to the property's value ($150 and $20, respectively) immediately after the transfer.

(v) *Basis of property received in transaction.* Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. The application of section 362(e)(2) is determined separately for each transferor. See §1.362–4(b).

(A) *FC's transfer.* Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC would have an aggregate basis of $270 in the transferred properties ($150 in A1, as determined under paragraph (iv) of this *Example 3*, plus $120 in A2, determined under section 362(a)), and the properties would have an aggregate value of $180 ($150 + $30) immediately after the transfer. Therefore, FC has a net built-in loss and FC's transfer of A1 and A2 is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), FC's $90 net built-in loss ($270 aggregate basis to DC over $180 aggregate value) would be allocated proportionately to reduce DC's basis in the loss property transferred by FC. As a result, FC's entire net built-in loss would be allocated to A2, the only loss property transferred by FC, and DC's basis in A2 would be $30 ($120 basis under section 362(a) reduced by $90 net built-

in loss). However, if FC and DC were to elect under section 362(e)(2)(C) to apply the $90 basis reduction to FC's basis in the DC stock received in the transaction, DC's basis in A2 would remain its section 362(a) basis of $120. DC's basis in A1 is $150 as determined under paragraph (iv) of this *Example 3* (irrespective of whether the section 362(e)(2)(C) election is made). If FC and DC do not make a section 362(e)(2)(C) election, FC's basis in the DC stock received in the exchange will be $160; if FC and DC do make the election, FC's basis in the DC stock will be $70 ($160 − $90 net built-in loss). See § 1.362–4.

(B) *F's transfer of A3.* Taking into account the application of section 362(e)(1) and this section, DC's basis in A3, the property transferred by F, would not exceed its value immediately after the transfer. Therefore, F does not have a built-in loss, F's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to F's transfer. DC's basis in A3, as determined under paragraph (iv) of this *Example 3,* is $20. Under section 358(a), F receives the DC stock with a basis of $140.

Example 4. Multiple transferors of non-importation properties. (i) *Facts.* DC1 owns A1 (basis $40, value $150). In addition, as in *Example 3* of this paragraph (f), FC owns A2 (basis $120, value $30), a U.S. real property interest as defined in section 897(c)(1), and F owns A3 (basis $140, value $20). On Date 1, DC1 transfers A1, FC transfers A2, and F transfers A3, to DC in a single transaction described in section 351.

(ii) *Importation property.* A2 is not importation property and A3 is importation property for the reasons set forth in paragraph (ii) of *Example 3* and paragraph (i)(B) of *Example 1* of this paragraph (f), respectively. A1 is not importation property because, if DC1 had sold A2 immediately before the transaction, DC1 would take into account any gain or loss recognized on the sale in determining its federal income tax liability.

(iii) *Loss importation transaction.* The transfer of A1, A2, and A3 is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in importation property, A3, would be $140 and the value of the property would be $20 immediately after the transaction. Therefore, the importation property's basis would exceed value and the transfer is a loss importation transaction.

(iv) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction.* Because the importation property, A3, was transferred in a loss importation transaction, section 362(e)(1) and paragraph (b)(1) of this section apply and DC's basis in A3 will be equal to A3's $20 value immediately after the transfer.

(v) *Basis of property received in transaction.* Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. The application of section 362(e)(2) is determined separately for each transferor. See § 1.362–4.

(A) *DC1's transfer.* Taking into account the application of section 362(e)(1) and this section, DC's basis in A1 ($40 under section 362(a)) would not exceed its value immediately after the transfer. Therefore, DC1 does not have a net built-in loss, DC1's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to DC1's transfer. DC's basis in A1, determined under section 362(a), is $40. Under section 358(a), DC1 receives the DC stock with a basis of $40.

(B) *FC's transfer.* Taking into account the application of section 362(e)(1) and this section, but without taking into account the provisions of section 362(e)(2), DC would have a section 362(a) basis of $120 in A2, which would exceed A2's $30 value immediately after the transfer. Therefore, FC has a net built-in loss and FC's transfer of A2 is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), FC's $90 net built-in loss (DC's $120 basis in A2 over A2's $30 value) would be applied to reduce DC's basis in A2, the only loss property transferred by FC. As a result, DC's basis in A2 would be $30 ($120 basis under section 362(a), reduced by the $90 net built-in loss). However, if FC and DC were to elect under section 362(e)(2)(C) to apply the $90 basis reduction to FC's basis in the DC stock received in the transaction, DC's basis in A2 would be its $120 basis determined under section 362(a). If FC and DC do not make a section 362(e)(2)(C) election, FC's basis in the DC stock received in the exchange will be $120; if FC and DC do make the election, FC's basis in the DC stock will be $30 ($120 − $90). See § 1.362–4.

(C) *F's transfer.* F's transfer of A3 is a transaction described in section 362(a). However, taking into account the application of section 362(e)(1) and this section, DC's basis in A3 ($20) would not exceed its value immediately after the transfer. Therefore, F does not have a built-in loss, F's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to F's transfer. DC's basis in A3, as determined under paragraph (iv) of this *Example 4,* is $20. Under section 358(a), F receives the DC stock with a basis of $140.

Example 5. Partnership transactions. (i) *Transfer by foreign partnership, foreign and domestic partners.* (A) *Facts.* A and F are equal partners in FP. FP owns A1 (basis $100, value $70). Under the terms of the FP partnership agreement, FP's items of income, gain, deduction, and loss are allocated equally between A and F. Section 704(c) does not apply with respect to the partnership property. FP

transfers A1 to DC in a transfer to which section 351 applies. No election is made under section 362(e)(2)(C).

(B) *Importation property.* If FP had sold A1 immediately before the transaction, any gain or loss recognized on the sale would be allocated to and includible by A and F equally under the partnership agreement. Thus, under paragraph (d)(2) of this section, A1 is treated as tentatively divided into two equal portions, one treated as owned by A and one treated as owned by F. If FP had sold A1 immediately before the transaction, any gain or loss recognized on the portion treated as owned by A would have been taken into account in determining a federal income tax liability (A's); thus A's tentatively divided portion of A1 is not importation property. However, no gain or loss recognized on the tentatively divided portion treated as owned by F would have been taken into account in determining a federal income tax liability. Further, if DC had sold A1 immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability (DC's); thus, F's tentatively divided portion of A1 is importation property.

(C) *Loss importation transaction.* FP's transfer of A1 is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in the importation property, F's portion of A1, would be $50 under section 362(a) and the property's value would be $35 immediately after the transaction. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction.

(D) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction.* Because the importation property, F's tentatively divided portion of A1, was transferred in a loss importation transaction, section 362(e)(1) and paragraph (b)(1) of this section apply and DC's basis in F's portion of A1 will be equal to its $35 value.

(E) *Basis of property received in transaction.* Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC's aggregate basis in A1 would be $85 (the sum of the $35 basis in F's tentatively divided portion of A1, as determined under paragraph (i)(D) of this *Example 5*, and the $50 basis in A's tentatively divided portion of A1, determined under section 362(a), see paragraphs (d)(2) and (e)(3) of this section) and A1's value immediately after the transfer would be $70. Therefore, FP has a net built-in loss and FP's transfer of A1 is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), FP's $15 net built-in loss ($85 basis over $70 value) would be allocated to reduce DC's basis in the loss asset, A1, the only loss property transferred by FP. As a result, DC's basis in A1 would be $70 ($85 basis under section 362(a) and this section, reduced by the $15 net built-in loss). Under section 358, FP's basis in the DC stock received in the exchange will be $100. See §1.362–4.

(ii) *Transfer with election to apply section 362(e)(2)(C).* The facts are the same as in paragraph (i)(A) of this *Example 5*, except that FP and DC elect to apply section 362(e)(2)(C) to reduce FP's basis in the DC stock received in the exchange. The analysis and results are the same as in paragraphs (i)(B), (C), (D), and (E) of this *Example 5*, except that the $15 reduction to DC's basis in A1 is not made and, as a result, DC's basis in A1 remains $85, and FP's basis in the DC stock received in the exchange is reduced from $100 to $85. The $15 reduction to FP's basis in DC stock reduces A's basis in its FP interest under section 705(a)(2)(B). See §1.362–4(e)(1).

(iii) *Transfer by domestic partnership.* The facts are the same as in paragraph (i)(A) of this *Example 5* except that FP is a domestic partnership. The analysis and results are the same as in paragraphs (i)(B), (C), (D), and (E) of this *Example 5*.

(iv) *Transfer of interest in partnership with liability.* (A) *Facts.* F and two other individuals are equal partners in FP. F's basis in its partnership interest is $247. F's share of FP's §1.752–1 liabilities (as defined in §1.752–1(a)(4)) is $150. F transfers his partnership interest to DC in a transaction to which section 351 applies. If DC were to sell the FP interest immediately after the transfer, DC would receive $100 in cash or other property. In addition, taking into account the rules under §1.752–4, DC's share of FP's §1.752–1 liabilities (as defined in §1.752–1(a)(4)) is $145 immediately after the transfer.

(B) *Importation property.* If F had sold his partnership interest immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Further, if DC had sold the partnership interest immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Therefore, F's partnership interest is importation property.

(C) *Loss importation transaction.* F's transfer is a section 362 transaction. However, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in the importation property, the partnership interest, determined under section 362(a) and taking into account the rules under section 752, would be $242 (F's $247 basis reduced by F's $150 share of FP liabilities and increased by DC's $145 share of FP liabilities) and, under paragraph (c)(4)(ii)

of this section, the value of the FP interest would be $245 (the sum of $100, the cash DC would receive if DC immediately sold the partnership interest, and $145, DC's share of the §1.752–1 liabilities (as defined in §1.752–1(a)(4)) under section 752 immediately after the transfer to DC). Therefore, the importation property's basis ($242) would not exceed its value ($245), and the transfer is not a loss importation transaction.

(D) *Basis in property received in transaction.* Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. As described in paragraph (iv)(C) of this *Example 5*, taking into account the application of section 362(e)(1) and this section, DC's basis in the partnership interest would not exceed its value. Therefore, under §1.362–4, F does not have a net built-in loss, the transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to the transfer. DC's basis in F's partnership interest is $242, determined under sections 362(a) and 752. Under section 358, taking into account the rules under section 752, F's basis in the DC stock received in the exchange is $97 ($247 reduced by F's $150 share of FP liabilities). If FP had elected under section 754, or if section 743(b) required a downward basis adjustment to the partnership property, FP would apply the rules of §1.743–1 to determine the amount of the basis adjustment to the partnership property.

Example 6. Transactions involving tax-exempt entities. (i) *Exempt transferor.* (A) *Facts.* InsCo is a benevolent life insurance association of a purely local character exempt from federal income tax under section 501(a) because it is described in section 501(c)(12). InsCo owns shares of stock of DC1 (basis $100, value $70) for investment purposes, which are not debt-financed property (as defined in section 514). On December 31, Year 1, InsCo transfers the DC1 stock to DC in exchange for DC stock in a transaction to which section 351 applies. No election is made under section 362(e)(2)(C).

(B) *Importation property.* If InsCo had sold the DC1 stock immediately before the transaction, any gain or loss realized would be excluded from UBTI under section 512(b)(5), and thus no gain or loss recognized on the sale would have been taken into account in determining federal income tax liability. Further, if DC had sold the DC1 stock immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining federal income tax liability. Therefore, the DC1 stock is importation property.

(C) *Loss importation transaction.* InsCo's transfer is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in importation property, the DC1 stock, would be $100, and the stock's value would be $70 immediately after the transaction. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction.

(D) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction.* Because the importation property, the DC1 stock, was transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in the stock will be equal to its $70 value.

(E) *Basis of property received in transaction.* Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section, DC's basis in the DC1 stock does not exceed its value immediately after the transaction. Therefore, InsCo does not have a net built-in loss, InsCo's transfer is not a loss duplication transaction, and section 362(e)(2) has no application to the transaction. DC's basis in the DC1 stock, as determined under paragraph (i)(D) of this *Example 6*, is $70. Under section 358, InsCo's basis in the DC stock received in the exchange will be $100.

(ii) *Transferor loses tax-exempt status.* (A) *Facts.* The facts are the same as in paragraph (i)(A) of this *Example 6* except that InsCo fails to be described in section 501(c)(12) in Year 1.

(B) *Importation property.* If InsCo had sold the DC1 stock immediately before the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Therefore, the DC1 stock is not importation property and this section does not apply to the transaction.

(C) *Basis of property received in transaction.* Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC would have a section 362(a) basis of $100 in the stock, which would exceed its value of $70 immediately after the transfer. Therefore, InsCo has a net built-in loss and InsCo's transfer of the DC1 stock is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), InsCo's $30 net built-in loss ($100 basis over $70 value) would be allocated to reduce DC's basis in the loss asset, the DC1 stock, the only loss property transferred by InsCo. As a result, DC's basis in the DC1 stock would be $70 ($100 basis under section 362(a), reduced by the $30 net built-in loss). Under section 358, InsCo's basis in the DC stock received in the exchange will be $100.

(iii) *Transfer of property that is subject to unrelated business tax.* (A) *Facts.* The facts are the same as in paragraph (i)(A) of this *Example 6* except that, on December 31, Year 1, instead of the DC1 stock, InsCo transfers A1 (basis $200, value $150) to DC. A1 is real property that InsCo owned from January 1 to December 31 of Year 1. During the entirety of this period, A1's basis was $200, and in the twelve months prior to December 31, Year 1, the highest amount of outstanding principal indebtedness on A1 was $40. For purposes of the UBTI rules under section 512, A1 is debt-financed property within the meaning of section 514(b).

(B) *Importation property.* If InsCo had sold A1 immediately before the transaction, 20 percent of any gain or loss recognized on that sale (that is, $40 of acquisition indebtedness on A1 divided by A1's $200 basis in Year 1) would, under sections 512 and 514, be includible in UBTI at the end of Year 1, and 80 percent would not. Thus, under paragraph (d)(4) of this section, A1 is treated as tentatively divided into two portions, one reflecting the gain or loss that would be taken into account in determining a federal income tax liability in InsCo's hands immediately before the transfer (the 20 percent portion) and one that would not (the 80 percent portion). Further, if DC sold A1 immediately after the transfer, any gain or loss on both portions would be taken into account in determining a federal income tax liability. Accordingly, the 20 percent portion is not importation property, but the 80 percent portion is.

(C) *Loss importation transaction.* InsCo's transfer of A1 is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in the importation property, the 80 percent portion of A1, would be $160 (80 percent of InsCo's $200 basis) under section 362(a) and the property's value would be $120 (80% of A1's $120 value) immediately after the transaction. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction.

(D) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction.* Because the importation property, the 80 percent portion of A1, was transferred in a loss importation transaction, section 362(e)(1) and paragraph (b)(1) of this section apply and DC's basis in that portion of A1 will be equal to its $120 value.

(E) *Basis of property received in transaction.* Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC's aggregate basis in A1 would be $160 (the sum of the $120 basis in the 80 percent importation portion of A1, as determined under paragraph (iii)(D) of this *Example 6*, and the $40 basis in the 20 percent portion of A1 that is not importation property, determined under section 362(a). See paragraph (e)(3) of this section). Further, A1's value immediately after the transfer would be $150. Therefore, InsCo has a net built-in loss in A1, and InsCo's transfer of A1 is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), InsCo's $10 net built-in loss ($160 basis over $150 value) would be allocated to reduce DC's basis in the loss asset, A1, the only loss property transferred by InsCo. As a result, DC's basis in A1 would be $150 ($160 basis under section 362(a) and this section, reduced by the $10 net built-in loss). Under section 358, InsCo's basis in the DC stock received in the exchange will be $200. See § 1.362–4.

(iv) *Transfer with election to apply section 362(e)(2)(C).* The facts are the same as in paragraph (iii)(A) of this *Example 6*, except that InsCo and DC elect to apply section 362(e)(2)(C) to reduce InsCo's basis in the DC stock received in the exchange. The analysis and results are the same as in paragraphs (iii)(B), (C), (D), and (E) of this *Example 6*, except that the $10 reduction to DC's basis in A1 is not made and, as a result, DC's basis in A1 remains $160; however, InsCo's basis in the DC stock received in the exchange is reduced from $200 to $190.

Example 7. Transactions involving CFCs. (i) *Transfer by CFC.* (A) *Facts.* FC is a CFC with 100 shares of stock outstanding. A owns 60 of the shares and F owns the remaining 40 shares. FC owns two assets, A1 (basis $70, value $100), which is used in the conduct of a U.S. trade or business, and A2 (basis $100, value $75), which is not used in the conduct of a U.S. trade or business. FC transfers both assets to DC in a transaction to which section 351 applies.

(B) *Importation property.* If FC had sold A1 immediately before the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability (FC's). See section 882(a). Therefore, A1 is not importation property. If FC had sold A2 immediately before the transaction, FC would not take the gain or loss recognized into account in determining its federal income tax liability, but the gain or loss could be taken into account in determining a section 951 inclusion to FC's U.S. shareholders. However, under paragraph (d)(3) of this section, gain or loss is not deemed taken into account in determining a federal income tax liability solely because it could affect an inclusion under section 951(a). Further, if DC had sold A2 immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Therefore, A2 is importation property.

(C) *Loss importation transaction.* FC's transfer is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in the importation property, A2, would be $100 and the property's value would be $75 immediately after the transaction. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction.

(D) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction.* Because the importation property, A2, was transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in A2 will be equal to A2's $75 value immediately after the transfer.

(E) *Basis of property received in transaction.* Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC would have an aggregate basis of $145 in the transferred properties ($70 in A1, determined under section 362(a), plus $75 in A2, determined under this section) and the properties would have an aggregate value of $175 ($100 + $75) immediately after the transfer. Therefore, FC does not have a net built-in loss, FC's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to the transaction. DC's basis in A1 will be $70, determined under section 362(a), and DC's basis in A2 will be $75, as determined under paragraph (i)(D) of this *Example 7.* Under the general rule in section 358(a), FC receives the DC stock with a basis of $170 ($70 attributable to A1 plus $100 attributable to A2).

(ii) *Transfer of CFC stock.* (A) *Facts.* The facts are the same as in paragraph (i)(A) of this *Example 7,* except that A transfers its 60 shares of FC stock (basis $80, value $105) and F transfers its 40 shares of FC stock (basis $100, value $70) to DC in an exchange that qualifies under section 351.

(B) *Importation property.* If A had sold its FC shares immediately before the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability (A's). Therefore, A's FC shares are not importation property. However, if F had sold its FC shares immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Further, if DC had sold F's FC shares immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Therefore, F's FC shares are importation property.

(C) *Loss importation transaction.* The transfer of the FC shares is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's aggregate basis in the importation property, F's shares of FC stock, would be $100 under section 362(a) and the shares' aggregate value would be $70. Therefore, the importation property's aggregate basis would exceed its aggregate value, and the transfer is a loss importation transaction.

(D) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction.* Because the importation property, F's shares of FC stock, was transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's aggregate basis in the shares will be equal to their $70 aggregate value immediately after the transfer.

(E) *Basis of property received in transaction.* Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. The application of section 362(e)(2) is determined separately for each transferor. See § 1.362–4(b).

(*1*) *A's transfer.* Taking into account the application of section 362(e)(1) and this section, DC's aggregate basis in the shares ($80 under section 362(a)) would not exceed the shares' value ($105) immediately after the transaction. Therefore A does not have a built-in loss, A's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to A's transfer. DC's aggregate basis in A's shares, determined under section 362(a), is $80. Under section 358(a), A receives the DC stock with a basis of $80.

(*2*) *F's transfer.* Taking into account the application of section 362(e)(1) and this section, DC's aggregate basis in the shares would not exceed their value immediately after the transaction. Therefore, F does not have a built-in loss, F's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to F's transfer. DC's aggregate basis in F's shares, as determined under paragraph (ii)(D) of this *Example 7,* is $70. Under section 358(a), F receives the DC stock with a basis of $100.

Example 8. Property subject to withholding tax. (i) *Facts.* FC owns a share of DC1 stock (basis $100, value $70) as an investment. FC receives dividends on the share that are subject to federal withholding tax of 30 percent of the amount received under section 881(a); under section 1442(a), DC1 must withhold tax on the dividends paid. FC transfers the DC1 share to DC in a transaction to which section 351 applies.

(ii) *Importation property.* Although any dividends received with respect to the DC1 stock were subject to withholding tax, if FC had sold the share of stock of DC1, no gain or loss recognized on the sale would have been

taken into account in determining a federal income tax liability. See section 865(a)(2). Further, if DC had sold the share of DC1 stock immediately after the transaction, any gain or loss recognized on the sale would be taken into account in determining federal income tax liability. Therefore, the share of DC1 stock is importation property.

(iii) *Loss importation transaction.* FC's transfer is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in the importation property, the share of DC1 stock, would be $100 and the share's value would be $70 immediately after the transaction. Therefore, the share's basis would exceed its value and the transfer is a loss importation transaction.

(iv) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction.* Because the importation property, the DC1 share, was transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in the share will be equal to the share's $70 value.

(v) *Basis of property received in transaction.* Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section, DC's basis in the DC1 share would not exceed the share's value immediately after the transaction. Therefore, FC does not have a net built-in loss, FC's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to the transaction. DC's basis in the DC1 share, as determined under paragraph (iv) of this *Example 8,* is $70. Under section 358, FC's basis in the DC stock received in the exchange will be $100.

Example 9. Property transferred in triangular reorganization. (i) *Foreign subsidiary.* (A) *Facts.* P owns the sole outstanding share of stock of FC (basis $1), FC1 owns the sole outstanding share of FC2 (basis $100), and FC2 owns one asset, A1 (basis $100, value $20). In a forward triangular merger described in §1.358–6(b)(2)(i), FC2 merges with and into FC, and FC1 receives shares of P stock in exchange for its FC2 stock. The forward triangular merger is a transaction described in section 368(a)(2)(D) and, therefore, in section 362(b).

(B) *Determining P's basis in its FC share.* Pursuant to §1.358–6, for purposes of determining the adjustment to P's basis in its FC shares, P is treated as though it first received A1 in a transaction in which its basis in A1 would be determined under section 362(b) and then it transferred A1 to FC in a transaction in which P's basis in its FC stock would be determined under section 358.

(*1*) *P's deemed acquisition and transfer of A1.* If FC2 had sold A1 for its value immediately before the deemed transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. If P had sold A1 immediately after the deemed transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability (P's). Therefore, with respect to P's deemed acquisition, A1 is importation property. Furthermore, immediately after the deemed transaction, P's basis in A1, but for section 362(e)(1) and this section and section 362(e)(2), would be $100 and A1's value is $20. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction. Accordingly, P's deemed basis in A1 will be equal to A1's $20 value.

(*2*) *P's FC stock basis.* As a result of P's deemed transfer of A1 to FC (and applying the principles of §1.367(b)–13), P's basis in its FC stock is increased by its $20 deemed basis in A1. Accordingly, following the transaction, P's basis in its share of FC stock will be $21 (the sum of its original $1 basis and the $20 adjustment for the deemed transfer of A1).

(C) *FC's basis in A1.* FC's basis in A1 is determined under the rules of this section without regard to the determination of P's adjustment to its basis in FC stock. If FC2 had sold A1 for its value immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. However, if FC had sold A1 immediately after the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability, so A1 is not importation property. Accordingly, this section will not apply to the transaction. Although there is a net built-in loss in A1, the transaction is not described in section 362(a), and so section 362(e)(2) and §1.362–4 will not apply to the transaction. Thus, under section 362(b), FC's basis in A1 will be $100.

(D) *FC1's basis in P stock.* Under section 358, FC1's basis in the P stock it receives in the exchange will be $100.

(ii) *Property transferred to U.S. subsidiary in triangular reorganization.* (A) *Facts.* The facts are the same as in paragraph (i)(A) of this *Example 9,* except that P also owns the sole outstanding share of DC (basis $1) and, instead of merging into FC, FC2 merged into DC.

(B) *Determining P's basis in its DC share.* As determined under paragraph (i)(B)(*2*) of this *Example 9,* P's basis in its DC share is $21, the sum of its original $1 basis plus the $20 adjustment for the deemed transfer of A1.

(C) *DC's basis in A1.* If FC2 had sold A1 for its value immediately before the transaction, no gain or loss recognized on the sale

would have been taken into account in determining a federal income tax liability. However, if DC had sold A1 immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability, so A1 is importation property with respect to DC. Furthermore, immediately after the transaction, DC's basis in A1, but for section 362(e)(1) and this section and section 362(e)(2), would be $100 and A1's value is $20. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction. Accordingly, DC's basis in A1 will be $20, A1's value immediately after the transaction.

(D) *FC1's basis in P stock.* Under section 358, FC1's basis in the P stock it receives in the exchange is $100.

(g) *Applicability date.* This section applies with respect to any transaction occurring on or after *March 28, 2016*, and also with respect to any transaction occurring before such date as a result of an entity classification election under §301.7701–3 of this chapter filed on or after *March 28, 2016,* unless such transaction is pursuant to a binding agreement that was in effect prior to *March 28, 2016* and at all times thereafter. In addition, taxpayers may apply this section to any transaction occurring after October 22, 2004.

[T.D. 9759, 81 FR 17075, Mar. 28, 2016]

§ 1.362–4 Basis of loss duplication property.

(a) *Purpose and scope*—(1) *In general.* The purpose of section 362(e)(2) and this section is to prevent the duplication of net loss in transfers to which section 351 applies, capital contributions, and paid-in surplus (each, a section 362(a) transaction). See paragraph (g) of this section for definitions of terms used in this section.

(2) *Intercompany transactions.* For rules relating to the application of section 362(e)(2) to transfers between members of a consolidated group on or after October 22, 2004, see §1.1502–80(h).

(b) *Basis determinations under section 362(e)(2) and this section.* Notwithstanding section 362(a), if a corporation (Acquiring) receives loss duplication property (as defined in paragraph (g)(1) of this section) from a person (Transferor) in a loss duplication transaction (as defined in paragraph (g)(2) of this section), Acquiring's basis in such property is equal to the basis of the property determined without regard to section 362(e)(2) and this section (as described in paragraph (g)(1)(ii) of this section), reduced by the property's allocable portion of Transferor's net built-in loss (as defined in paragraph (g)(3) of this section). If more than one Transferor transfers property to a corporation in a section 362(a) transaction, whether and the extent to which section 362(e)(2) and this section apply is determined separately for each Transferor.

(c) *Exceptions and special rules*—(1) *Transactions in which net built-in loss is eliminated without recognition.* Section 362(e)(2) does not apply to a transaction to the extent that—

(i) Without recognizing gain or loss, Transferor distributes the Acquiring stock received in the transaction; and

(ii) Upon completion of the transaction, no person holds Acquiring stock or any other asset with a basis determined, in whole or in part, by reference to Transferor's basis in the distributed Acquiring stock.

(2) *Certain transactions outside of the United States.* Section 362(e)(2) does not apply to a transaction if—

(i) Neither Transferor nor Acquiring is a U.S. person (as defined in section 7701(a)(30)), a person otherwise required to file a U.S. return for the year of the transaction, a controlled foreign corporation (CFC, as defined in paragraph (g)(7) of this section), or a controlled foreign partnership (CFP, as defined in paragraph (g)(9) of this section) on the date of the transaction;

(ii) The transfer occurs more than two years prior to the date of any event described in paragraph (d)(3)(ii)(E), (F), or (G) of this section; and

(iii) The original transaction and the event or events described in paragraph (d)(3)(ii)(E), (F), or (G) of this section were not entered into with a view to reducing or avoiding the Federal income tax liability of any person by avoiding the application of section 362(e)(2) and this section to the original transaction.

(3) *Other effects of basis determination under this section*—(i) *Determination by reference to transferor's basis.* A determination of basis under this section is

a determination by reference to the transferor's basis, including for purposes of sections 755, 1223(2), and 7701(a)(43).

(ii) *Treatment as tax-exempt income or noncapital, nondeductible expense.* A determination of basis under paragraph (b) of this section does not give rise to an item treated as a noncapital, nondeductible expense under §1.1502–32(b)(2)(iii). However, a determination of basis under paragraph (d) of this section does give rise to an item treated as a noncapital, nondeductible expense under §1.1502–32(b)(2)(iii).

(d) *Election to reduce Transferor's stock basis instead of Acquiring's asset basis*—(1) *In general.* In lieu of making the basis reductions otherwise required under paragraph (b) of this section, Transferor and Acquiring may elect to reduce Transferor's basis in Acquiring stock that is received in the transaction without the recognition of gain or loss (the section 362(e)(2)(C) election). The section 362(e)(2)(C) election may be made protectively and will have no effect to the extent that property transferred in the transaction is determined not to be subject to section 362(e)(2) and this section. However, the election is irrevocable once it is made. A section 362(e)(2)(C) election is made and effective if—

(i) Prior to the filing of a Section 362(e)(2)(C) Statement (described in paragraph (d)(3)(i) of this section), Transferor and Acquiring enter into a written, binding agreement to elect to apply section 362(e)(2)(C); and

(ii) The Section 362(e)(2)(C) Statement is filed in accordance with the provisions of paragraph (d)(3) of this section.

(2) *Effect of section 362(e)(2)(C) election.* If a section 362(e)(2)(C) election is made and in effect—

(i) An amount equal to the portion of Transferor's net built-in loss (as defined in paragraph (g)(3) of this section) that would otherwise be applied to reduce asset basis under paragraph (b) of this section is allocated among the Acquiring shares received or deemed received in the exchange (in proportion to the value of such shares) and applied to reduce Transferor's basis (determined without regard to section 362(e)(2) and this section) in each such share; and

(ii) Acquiring's basis in loss duplication property received from Transferor in the transaction is not determined under section 362(e)(2) and this section.

(3) *Section 362(e)(2)(C) Statement*—(i) *Form and contents of statement.* The Section 362(e)(2)(C) Statement is to be titled ''Section 362(e)(2)(C) Statement.'' The Section 362(e)(2)(C) Statement must—

(A) Identify (by name and tax identification number, if any) Transferor and Acquiring;

(B) State that Transferor and Acquiring have entered into a written, binding agreement to elect to apply section 362(e)(2)(C) as required in paragraph (d)(1)(i) of this section; and

(C) State the date of the transaction (or, if the transaction includes transfers on more than one date, then the dates of all transfers) to which the election applies.

(ii) *Filing the Section 362(e)(2)(C) Statement.* In general, the Section 362(e)(2)(C) Statement is filed by the person or entity described in the applicable paragraph of this paragraph (d)(3)(ii). Thus, if Transferor is a partnership, S corporation, trust (including a subpart E trust), or other passthrough entity, or Acquiring is an S corporation, the entity (and not the partners, shareholders, or other persons having an interest in the entity or its property) is the person that must file the Section 362(e)(2)(C) Statement, without regard to whether such entity is foreign or domestic. However, in the case of a CFC or CFP, the controlling U.S. shareholders of the CFC or the reporting U.S. partners of the CFP, respectively, file the Section 362(e)(2)(C) Statement.

(A) *Transferor is a person required to file a U.S. return.* If Transferor is a person required to file a U.S. return for the year of the transfer, Transferor must include the Section 362(e)(2)(C) Statement on or with its timely filed (including extensions) original U.S. return for the taxable year in which the transfer occurred.

(B) *Transferor is a CFC or CFP and not required to file a U.S. return.* If paragraph (d)(3)(ii)(A) of this section does not apply and Transferor is either a

CFC or a CFP on the date of the transfer, all of Transferor's controlling U.S. shareholders (in the case of a CFC) or all of Transferor's reporting U.S. partners (in the case of a CFP) must include the Section 362(e)(2)(C) Statement on or with their timely filed (including extensions) original U.S. returns for their taxable years in which the transfer occurred.

(C) *Transferor is not a person required to file a U.S. return, a CFC, or a CFP, but Acquiring is required to file U.S. return.* If paragraphs (d)(3)(ii)(A) and (B) of this section do not apply and Acquiring is a person required to file a U.S. return for the year of the transfer, Acquiring must include the Section 362(e)(2)(C) Statement on or with its timely filed (including extensions) original U.S. return for the taxable year in which the transfer occurred.

(D) *Transferor is not a person required to file a U.S. return, a CFC, or a CFP, Acquiring is not required to file a U.S. return, but Acquiring is a CFC.* If paragraphs (d)(3)(ii)(A) through (C) of this section do not apply and Acquiring is a CFC on the date of the transfer, all of Acquiring's controlling U.S. shareholders must include the Section 362(e)(2)(C) Statement on or with their timely filed (including extensions) original U.S. returns for their taxable years in which the transfer occurred.

(E) *Neither Transferor nor Acquiring is a person required to file a U.S. return, a CFC, or a CFP, but Transferor later becomes a person required to file a U.S. return, a CFC, or a CFP.* If paragraphs (d)(3)(ii)(A) through (D) of this section do not apply and Transferor becomes a person required to file a U.S. return, a CFC, or a CFP, Transferor (if required to file a U.S. return), all of Transferor's controlling U.S. shareholders (if Transferor becomes a CFC not otherwise required to file a U.S. return), or all of Transferor's reporting U.S. partners (if Transferor becomes a CFP not otherwise required to file a U.S. return) must include the Section 362(e)(2)(C) Statement on or with their timely filed (including extensions) original U.S. returns for their taxable years in which an event described in this paragraph (d)(3)(ii)(E) first occurs. For purposes of this paragraph (d)(3)(ii)(E), the term Transferor includes any person holding property with a basis determined directly or indirectly by reference to Transferor's basis in the Acquiring stock received in the transaction.

(F) *Transferor is not and does not become a person required to file a U.S. return, a CFC, or a CFP, Acquiring is not, but later becomes either a person required to file a U.S. return, a CFC, or a CFP.* If paragraphs (d)(3)(ii)(A) through (E) of this section do not apply and Acquiring becomes a person required to file a U.S. return, a CFC, or a CFP, Acquiring (if required to file a U.S. return), all of Acquiring's controlling U.S. shareholders (if Acquiring becomes a CFC not otherwise required to file a U.S. return), or all of Acquiring's reporting U.S. partners (if Acquiring becomes a CFP not otherwise required to file a U.S. return) must include the Section 362(e)(2)(C) Statement on or with their timely filed (including extensions) original U.S. returns for their taxable years in which an event described in this paragraph (d)(3)(ii)(F) first occurs. For purposes of this paragraph (d)(3)(ii)(F), the term Acquiring includes any person holding property with a basis determined directly or indirectly by reference to Acquiring's basis in loss duplication property received in the transaction.

(G) *Transferor and Acquiring are not and do not become a person required to file a U.S. return, a CFC, or a CFP, but the basis of the loss duplication property or Acquiring stock later becomes relevant for Federal tax purposes.* If paragraphs (d)(3)(ii)(A) through (F) of this section do not apply and, in a transferred basis transaction, a person required to file a U.S. return, a CFC, or a CFP acquires either loss duplication property or Acquiring stock that was received in the loss duplication transaction, or any property the basis of which is determined in whole or in part by reference to any such property or stock, all such persons (or, in the case of a CFC or CFP not required to file a U.S. return, all the controlling U.S. shareholders or all the reporting U.S. partners, as applicable) must include the Section 362(e)(2)(C) Statement on or with their timely filed (including extensions) original U.S. returns for their first taxable year(s) in which there occurs an

event or events described in this paragraph (d)(3)(ii)(G).

(e) *Transfers by partnerships and S corporations*—(1) *Transfers by partnerships.* If a partnership transfers property in a loss duplication transaction with respect to which a section 362(e)(2)(C) election is made, the resulting reduction to the partnership's basis in the Acquiring stock received in exchange for the loss duplication property is treated as an expenditure of the partnership described in section 705(a)(2)(B).

(2) *Transfers by S corporations.* If an S corporation transfers property in a loss duplication transaction with respect to which a section 362(e)(2)(C) election is made, the resulting reduction to the S corporation's basis in the Acquiring stock received in exchange for the loss duplication property is treated as an expense of the S corporation described in section 1367(a)(2)(D).

(f) *Transfers to S corporations.* If a person transfers property to an S corporation in a loss duplication transaction, any resulting reduction under section 362(e)(2) and this section to the S corporation's basis in the property received is not treated as an expense of the S corporation described in section 1367(a)(2)(D).

(g) *Definitions.* For purposes of section 362(e)(2) and this section—

(1) *Loss duplication property* is any property—

(i) That is transferred by Transferor to Acquiring in a loss duplication transaction (as defined in paragraph (g)(2) of this section); and

(ii) That Acquiring would take with a basis in excess of value immediately after the transaction; for this purpose, the basis Acquiring would take in the property is determined immediately after the transaction and without regard to section 362(e)(2) and this section, but otherwise taking into account all applicable provisions of law, including, without limitation, section 362(e)(1).

(2) A *loss duplication transaction* is a section 362(a) transaction in which Acquiring's aggregate basis in the property received from Transferor would, but for section 362(e)(2) and this section, exceed the aggregate value of such property immediately after the transaction. For this purpose—

(i) A transaction is a section 362(a) transaction if it is described in section 362(a) without regard to whether it is also described in any other provision of the Internal Revenue Code (Code), including, without limitation, section 362(b); and

(ii) Acquiring's aggregate basis in the property received from Transferor is determined immediately after the transaction and without regard to section 362(e)(2) and this section, but otherwise taking into account all applicable provisions of law, including, without limitation, section 362(e)(1).

(3) *Transferor's net built-in loss* is the excess of—

(i) Acquiring's aggregate basis (determined under paragraph (g)(2)(ii) of this section) in all property received from Transferor in a loss duplication transaction, over

(ii) The aggregate value of such property immediately after the transaction.

(4) A property's *built-in loss* is the excess of Acquiring's basis in the property (determined as described in paragraph (g)(1)(ii) of this section) over the property's value (determined immediately after the transaction).

(5) A property's *allocable portion of Transferor's net built-in loss* is the portion of Transferor's net built-in loss that bears the same ratio to Transferor's net built-in loss that the property's built-in loss bears to the aggregate built-in losses reflected in the bases of loss duplication property transferred by Transferor in the transaction.

(6) A *U.S. return* is a return of income under section 6012 or an information return under Subtitle F, Chapter 61, Subchapter A, Part III of the Code (sections 6031 and following) or the regulations thereunder, that the taxpayer is unconditionally required to file. Thus, the term does not include elective forms or statements that are required to be filed only to obtain a particular tax treatment, including forms filed to make an election or to reduce or avoid withholding by a person not otherwise

required to file a U.S. return (as described in this paragraph (g)(6)) (for example, a notice of nonrecognition under §1.1445–2(d)).

(7) A *controlled foreign corporation* (CFC) is any corporation described in section 957 or section 953(c).

(8) A *controlling U.S. shareholder* is any person that is treated as a controlling U.S. shareholder under §1.964–1(c)(5) because such person either owns a direct interest in the CFC or is treated as owning an interest in the CFC by reason of section 318(a)(2) (attribution from partnerships, estates, trusts, and corporations).

(9) A *controlled foreign partnership* (CFP) is any partnership treated as a controlled foreign partnership for purposes of section 6038.

(10) A *reporting U.S. partner* is any partner of a CFP that is required to file an information return with respect to the CFP pursuant to section 6038 or the regulations thereunder, without regard to §1.6038–3(c) or (j). In addition, in applying the constructive ownership rules of §1.6038–3(b)(4), the term ''nonresident alien'' is replaced by the term ''individual.''

(11) The term *stock* means both Acquiring stock and Acquiring securities received by Transferor in the transaction if gain or loss on the receipt of the stock or securities is not recognized in whole or in part.

(12) *Value*—(i) *General rule.* The term *value* means fair market value.

(ii) *Special rule for transfers of partnership interests.* Notwithstanding the general rule in paragraph (g)(12)(i) of this section, when referring to a partnership interest, for purposes of section 362(e)(2) and this section, the term *value* means the sum of the cash that Acquiring would receive for the interest, assuming an exchange between a willing buyer and a willing seller (neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts), increased by any §1.752–1 liabilities (as defined in §1.752–1(a)(4)) of the partnership allocated to Acquiring with regard to such transferred interest under section 752 immediately after the transfer to Acquiring. See §1.743–1 regarding the application of section 743(b) following a section 362(e) basis reduction.

(h) *Examples.* The examples in this paragraph (h) illustrate the application of section 362(e)(2) and the provisions of this section. Unless the facts otherwise indicate, the examples use the following nomenclature and assumptions: X, Y, P, S, S1, and S2 are domestic corporations; A and B are U.S. individuals; FC1 and FC2 are foreign corporations and are not engaged in a U.S. trade or business, have no U.S. real property interests, and have no other relationships, activities, or interests that would cause them, their shareholders, or their property to be subject to tax imposed under any provision of subtitle A of the Internal Revenue Code (federal income tax); there is no applicable income tax treaty; PRS is a domestic partnership; no election is made under section 362(e)(2)(C); and the transferred property is not importation property (as defined in §1.362–3(c)(2)) and the transfers are not loss importation transactions (as defined in §1.362–3(c)(3)), so that the basis of no property is determined under section 362(e)(1). All persons and transactions are unrelated unless the facts indicate otherwise, all taxpayers are on a calendar tax year, and all other relevant facts are set forth in the examples. See §1.362–3(f) for additional examples illustrating the application of section 362(e)(2) and this section, including to transactions that are subject to section 362(e)(2), and section 362(e)(1).

Example 1. Transfer described in section 351. (i) *Basic application of section.* (A) *Facts.* A owns Asset 1 (basis $90, value $60) and Asset 2 (basis $110, value $120). In a transaction to which section 351 applies, A transfers Asset 1 and Asset 2 to X in exchange for a single outstanding share of X stock representing all the outstanding X stock immediately after the transaction.

(B) *Analysis—(1) Loss duplication transaction.* A's transfer of Asset 1 and Asset 2 is a section 362(a) transaction. But for section 362(e)(2) and this section, X's aggregate basis in those assets would be $200 ($90 + $110), which would exceed the aggregate value of the assets $180 ($60 + $120) immediately after the transaction. Accordingly, the transfer is a loss duplication transaction and A has a net built-in loss of $20 ($200 − $180).

(*2*) *Identifying loss duplication property.* But for section 362(e)(2) and this section, X's basis in Asset 1 would be $90, which would exceed Asset 1's $60 value immediately after the transaction. Accordingly, Asset 1 is loss

duplication property. But for section 362(e)(2) and this section, X's basis in Asset 2 would be $110, which would not exceed Asset 2's $120 value immediately after the transaction. Accordingly, Asset 2 is not loss duplication property.

(C) *Basis in loss duplication property.* X's basis in Asset 1 is $70, computed as its $90 basis under section 362(a) reduced by A's $20 net built-in loss.

(D) *Basis in other property.* Under section 362(a), X has a transferred basis of $110 in Asset 2. Under section 358(a), A has an exchanged basis of $200 in the X stock it receives in the transaction.

(ii) *Section 362(e)(2)(C) election.* The facts are the same as in paragraph (i)(A) of this *Example 1,* except that A and X make an election under section 362(e)(2)(C). Under paragraph (d)(2)(i) of this section, A reduces its basis in the X stock, as determined without regard to section 362(e)(2) and this section, by the amount of A's net built-in loss that would have been applied to reduce X's basis in Asset 1 had the section 362(e)(2)(C) election not been made. In addition, no reduction is made to X's basis in Asset 1, as determined without regard to section 362(e)(2) and this section. As a result, A's basis in the X stock is $180 ($200 − $20), X's basis in Asset 1 is $90, and X's basis in Asset 2 is $110.

Example 2. Transfer described in both section 351 and section 368(a)(1)(B). (i) *Basic application of section*—(A) *Facts.* P owns the sole outstanding share of S1 stock and the ten outstanding shares of S2 stock. In a transaction to which section 351 applies and that is described in section 368(a)(1)(B), P transfers its ten S2 shares to S1 in exchange for an additional ten shares of S1 voting stock. At the time of the transfer, P has a basis of $10 each in five of its S2 shares (Shares 1–5) and a basis of $5 each in its other five S2 shares (Shares 6–10), and the value of each share is $7.

(B) *Analysis—(1) Loss duplication transaction.* P's transfer of the S2 shares is a section 362(a) transaction notwithstanding that it is also a transaction described in section 368(a)(1)(B) and therefore section 362(b). But for section 362(e)(2) and this section, S1's aggregate basis in the S2 shares would be $75 ($10 × 5, or $50, for Shares 1–5 + $5 × 5, or $25, for Shares 6–10). Thus, S1's $75 aggregate basis in the shares would exceed the aggregate value of the shares, $70 ($7 × 10 shares), immediately after the transaction. Accordingly, the transfer is a loss duplication transaction and P has a net built-in loss of $5 ($75 − $70).

(*2*) *Identifying loss duplication property.* But for section 362(e)(2) and this section, S1's basis in each of Shares 1–5 would be $10, which would exceed each share's $7 value immediately after the transaction. Accordingly, Shares 1–5 are each loss duplication property. But for section 362(e)(2) and this section, S1's basis in each of Shares 6–10 would be $5, which would not exceed each share's $7 value immediately after the transaction. Accordingly, Shares 6–10 are not loss duplication property.

(C) *Basis in loss duplication property.* S1's basis in each of Shares 1–5 is $9, computed as its $10 basis (determined without regard to section 362(e)(2) and this section) reduced by $1, the share's allocable portion (1/5) of P's net built-in loss ($5).

(D) *Basis in other property.* Under section 362(a), S1 has a transferred basis of $5 in each of Shares 6–10. Under section 358(a), P has an exchanged basis in the ten S1 shares it receives in the exchange ($10 in each of the five S1 shares received in exchange for Shares 1–5 and $5 in each of the five S1 shares received in exchange for Shares 5–10).

(ii) *Section 362(e)(2)(C) election.* The facts are the same as in paragraph (i)(A) of this *Example 2,* except that an election under section 362(e)(2)(C) is made to reduce P's basis in the shares of S1 stock received in the exchange. Under paragraph (d)(2)(i) of this section, P reduces its basis in the S1 stock by $5, the amount of P's net built-in loss that S1's basis in the S2 shares would have been reduced under section 362(e)(2) and this section had the section 362(e)(2)(C) election not been made, and no reduction is made to S1's basis in the S2 stock (as determined without regard to section 362(e)(2) and this section). Because an election is being made under section 362(e)(2)(C), P's basis in the new S1 shares is not determined under the general rule of §1.358–2(a)(2)(i) (under which P's basis in each new S1 share would be equal to the basis of the S2 share transferred in exchange for the S1 share). Section 1.358–2(a)(2)(viii)(B). Accordingly, P's basis in each new S1 share will be $7, the share's allocable portion of P's $75 aggregate basis in the S2 shares transferred in the transaction (or, $7.50 per share), reduced under paragraph (d)(2)(i) of this section by the $5 that would have been applied to reduce S1's basis in the S2 shares had the section 362(e)(2)(C) election not been made (or $.50 per share). Under paragraph (d)(2)(ii) of this section and section 362(a), S1 receives five shares of the S2 stock with a basis of $10 each and five shares of the S2 stock with a basis of $5 each.

Example 3. Transfer described in both section 351 and section 368(a)(1)(A), multiple transferors, elimination of duplicated loss. (i) *Facts.* A owns Asset 1 (basis $120, value $130) and all the outstanding shares of X stock. B owns all the outstanding shares of Y stock (basis $150). Y owns Asset 2 (basis $250, value $210). Pursuant to a single plan, A transfers Asset 1 to X in exchange for additional X shares and, in a transaction qualifying as a reorganization described in section 368(a)(1)(A), Y merges with and into X. In the merger, B receives X stock with a basis equal to B's basis

in its Y stock immediately before the merger. A's transfer of Asset 1 to X in exchange for X stock and Y's transfer of Asset 2 to X in the merger are both transactions to which section 351 applies. Notwithstanding that the transfers by A and Y are pursuant to a single plan forming one transaction, section 362(e)(2) and this section apply to each transferor separately.

(ii) *Application of section to A's transfer of Asset 1.* A's transfer of Asset 1 is a section 362(a) transaction. But for section 362(e)(2) and this section, X's basis in Asset 1 would be $120, which would not exceed Asset 1's $130 value immediately after the transaction. Accordingly, A's transfer of Asset 1 is not a loss duplication transaction notwithstanding that, taking both A's transfer and Y's transfer into account, X has an aggregate net loss in Asset 1 and Asset 2. Because Asset 1 is not received in a loss duplication transaction, it is not loss duplication property and section 362(e)(2) and this section do not apply to A's transfer of Asset 1.

(iii) *Application of section to Y's transfer of Asset 2*—(A) *Analysis—(1) Loss duplication transaction.* Y's transfer of Asset 2 to X is a section 362(a) transaction, notwithstanding that it is also a transaction described in section 368(a)(1)(A) and therefore section 362(b). But for section 362(e)(2) and this section, X's basis in Asset 2 would be $250, which would exceed Asset 2's $210 value immediately after the transaction. Accordingly, Y's transfer is a loss duplication transaction and Y has a net built-in loss of $40.

(*2*) *Identifying loss duplication property.* But for section 362(e)(2) and this section, X's basis in Asset 2 would be $250, which would exceed Asset 2's $210 value immediately after the transaction. Accordingly, Asset 2 is loss duplication property.

(B) *Basis in loss duplication property.* Although Asset 2 is loss duplication property, section 362(e)(2) does not apply to Y's transfer of Asset 2 to X because Y distributes all of the X stock received in the exchange without recognizing gain or loss, and, upon completion of the transaction, no person will hold the X stock or any other asset with a basis determined in whole or in part by reference to Y's basis in such stock. Accordingly, under paragraph (c)(1) of this section, X's basis in Asset 2 is not determined under section 362(e)(2) and this section. Thus, under section 362(a), X's basis in Asset 2 is $250.

(iv) *Basis in other property.* Under section 358, A's basis in the X stock received in exchange for Asset 1 is $120 and B's basis in the X stock received in the merger is $150. Under section 362(a), X's basis in Asset 1 is $120.

Example 4. Transfer described in both section 351 and section 368(a)(1)(D), followed by a distribution qualifying under section 355. (i) *Basic transaction*—(A) *Facts.* A and B each own one of the two outstanding shares of X common stock. X's assets include Asset 1 (basis $120, value $70), Asset 2 (basis $160, value $110), and Asset 3 (basis $220, value $240). In a transaction to which section 351 applies and that is described in section 368(a)(1)(D), X transfers Asset 1, Asset 2, and Asset 3 to Y in exchange for all the Y stock; then, in a distribution that qualifies under section 355, X distributes all the Y stock received in the exchange to A in exchange for all of A's X stock. Under section 361(c)(1), X does not recognize gain or loss as a result of the distribution of all the Y stock.

(B) *Analysis—(1) Loss duplication transaction.* X's transfer of Asset 1, Asset 2, and Asset 3 is a section 362(a) transaction. But for section 362(e)(2) and this section, Y's aggregate basis in those assets would be $500 ($120 + $160 + $220). The aggregate value of the assets immediately after the transaction is $420 ($70 + $110 + $240). Thus, Y's aggregate basis in the assets would exceed the aggregate value of the assets immediately after the transaction. Accordingly, the transfer is a loss duplication transaction and X has a net built-in loss of $80 ($500 − $420).

(*2*) *Identifying loss duplication property.* But for section 362(e)(2) and this section, Y's basis in Asset 1 would be $120, which would exceed Asset 1's $70 value immediately after the transaction. Accordingly, Asset 1 is loss duplication property. But for section 362(e)(2) and this section, Y's basis in Asset 2 would be $160, which would exceed Asset 2's $110 value immediately after the transaction. Accordingly, Asset 2 is also loss duplication property. But for section 362(e)(2) and this section, Y's basis in Asset 3 would be $220 and would therefore not exceed Asset 3's $240 value immediately after the transaction. Accordingly, Asset 3 is not loss duplication property.

(C) *Basis in loss duplication property.* Although Asset 1 and Asset 2 are each loss duplication property, X will distribute the Y stock received in exchange for Asset 1 and Asset 2 without recognition of gain or loss, and, upon completion of the transaction, no person will hold the Y stock received by X or any other asset with a basis determined in whole or in part by reference to X's basis in the Y stock received in the exchange. (A's basis in the Y stock will be determined by reference to his basis in his X stock.) Accordingly, under paragraph (c)(1) of this section, Y's bases in Asset 1 and Asset 2 are determined under section 362(a) and not under section 362(e)(2) and this section. Thus, Y's basis in Asset 1 is $120 and Y's basis in Asset 2 is $160.

(D) *Basis in other property.* Under section 358, A's basis in the Y stock received in exchange for his X stock is determined by reference to his basis in his X stock surrendered. Under section 362(a), Y's basis in Asset 3 is $220.

(ii) *Section 355(e)*—(A) *Facts.* The facts are the same as in paragraph (i)(A) of this *Example 4*, except that, after the section 355 distribution, Y is acquired pursuant to a plan (within the meaning of §1.355–7), resulting in the application of section 355(e) to the transactions.

(B) *Analysis.* Because section 361(c)(2), and not section 361(c)(1), will apply to X's distribution of Y stock, X will not qualify for nonrecognition treatment on the distribution of the Y stock. As a result, paragraph (c)(1) of this section does not apply to the transaction, and Y's bases in Asset 1 and Asset 2, the loss duplication property, are determined under section 362(e)(2) and this section. Asset 1 has a built-in loss of $50 ($120 − $70), and Asset 2 has a built-in loss of $50 ($160 − $110). Thus, Asset 1's allocable portion of X's net built-in loss is $40 ($50/$100 × $80), and Asset 2's allocable portion of X's net built-in loss is $40 ($50/$100 × $80). Accordingly, Y receives Asset 1 with a basis of $80 ($120 − $40) and Asset 2 with a basis of $120 ($160 − $40).

(iii) *Retained stock and securities*—(A) *Facts.* The facts are the same as in paragraph (i)(A) of this *Example 4*, except that X transfers Asset 1, Asset 2, and Asset 3 to Y in exchange for Y stock and Y securities, each constituting half of the consideration. In addition, for a valid business purpose, X retains Y stock and Y securities each worth 1 percent of the total consideration.

(B) *Analysis.* Paragraph (c)(1) of this section applies only to the extent that stock received in a transaction is distributed without recognition of gain or loss. Thus, section 362(e)(2) and this section apply to the extent that property was exchanged for the retained Y stock and Y securities (2 percent of the total). Accordingly, Y reduces its basis in Asset 1 and in Asset 2, the loss duplication property, by $1.60 (two percent of X's $80 net built-in loss). Asset 1 has a built-in loss of $50 ($120 − $70), and Asset 2 has a built-in loss of $50 ($160 − $110). Thus, Asset 1's allocable portion of X's net built-in loss is $.80 ($50/$100 × $1.60), and Asset 2's allocable portion of X's net built-in loss is $.80 ($50/$100 × $1.60). As a result, Y receives Asset 1 with a basis of $119.20 ($120 − $.80) and Asset 2 with a basis of $159.20 ($160 − $.80).

(iv) *Retained stock and securities with a section 362(e)(2)(C) election*—(A) *Facts.* The facts are the same as in paragraph (iii)(A) of this *Example 4*, except that an election under section 362(e)(2)(C) is made to reduce X's bases in its retained Y stock and retained Y securities.

(B) *Analysis.* Under paragraph (d)(2)(i) of this section, X reduces its basis in the retained Y stock and the retained Y securities (determined without regard to section 362(e)(2) and this section) by $1.60, the portion of X's $80 net built-in loss that would have been applied to reduce Y's basis in the transferred assets had the election to apply section 362(e)(2)(C) not been made. (Because the value of the Y stock and the value of the Y securities are equal, X's $500 basis in the transferred property would be allocated equally between the Y stock and the Y securities, $250 to each, under §1.358–2(b)(2), and the retained Y stock and Y securities have a basis of $2.50 each (one percent of $250).) For the reasons set forth in paragraph (iii)(B) of this *Example 4,* Y would have been required to reduce its basis in the transferred assets by $1.60. Accordingly, X must reduce its aggregate basis in the retained Y stock and Y securities by $1.60. Under paragraph (d)(2)(i) of this section, the $1.60 basis reduction is allocated and applied to reduce X's bases in the retained Y stock and Y securities in proportion to the value of each. Because X retained Y stock and Y securities with equal values, X holds each of the retained Y stock and securities with an adjusted basis of $1.70 ($2.50 − $.80). Under paragraph (d)(2)(ii) of this section, Y receives Asset 1 with a basis of $120, Asset 2 with a basis of $160, and Asset 3 with a basis of $220.

Example 5. Transfer of liabilities. (i) *Liabilities described in section 358(d)(1)*—(A) *Basic application of section, no section 362(e)(2)(C) election—(1) Facts.* A owns Asset 1 (basis $800, value $700). A also has a $200 liability that has been taken into account for tax purposes and is thus described in section 358(d)(1), and not in sections 357(c)(3), 358(d)(2), and 358(h)(1). A transfers Asset 1 to X in exchange for a single outstanding share of X stock representing all the outstanding X stock immediately after the transaction and X's assumption of the liability. The transfer is a transaction to which section 351 applies.

(*2*) *Analysis*—(*i*) *Loss duplication transaction.* A's transfer of Asset 1 is a section 362(a) transaction. But for section 362(e)(2) and this section, X's basis in Asset 1 would be $800, which would exceed Asset 1's $700 value immediately after the transaction. Accordingly, the transfer is a loss duplication transaction and A has a net built-in loss of $100 ($800 − $700).

(*ii*) *Identifying loss duplication property.* But for section 362(e)(2) and this section, X's basis in Asset 1 would be $800, which would exceed the $700 value of Asset 1 immediately after the transaction. Accordingly, Asset 1 is loss duplication property.

(*3*) *Basis in loss duplication property.* X's basis in Asset 1 is $700, computed as its $800 basis determined under section 362(a) reduced by A's $100 net built-in loss.

(*4*) *Basis in other property.* Under sections 358(a) and (d)(1), A's basis in the X stock is $600 ($800 basis in property transferred—$200 liability assumed).

(B) *Section 362(e)(2)(C) election.* The facts are the same as in paragraph (i)(A)(*1*) of this *Example 5,* except that A and X make an election under section 362(e)(2)(C). In this case,

A's $100 net built-in loss that would have been applied to reduce X's basis in Asset 1 is applied to reduce A's basis in the X stock received. As a result, A's basis in the X stock is $500 ($600, as determined in paragraph (i)(A)(*4*) of this *Example 5*, reduced by $100) and X's basis in Asset 1 is $800.

(ii) *Contingent liabilities described in section 358(h)(1), section 358(h)(2)(A) exception applies*—(A) *Facts.* The facts are the same as in paragraph (i)(A)(*1*) of this *Example 5*, except that A's liability (valued at $200) has not been taken into account for tax purposes and is described in sections 358(d)(2) and 358(h)(1). However, Asset 1 is a trade or business and the liability is associated with the trade or business; as a result, the liability is described in section 358(h)(2)(A) and is excepted from the general rule of section 358(h)(1).

(B) *Analysis.* For the reasons set forth in paragraph (i)(A)(*2*) of this *Example 5*, A's transfer of Asset 1 is a loss duplication transaction, A has a net built-in loss of $100, and Asset 1 is loss duplication property.

(C) *Basis in loss duplication property.* For the reasons set forth in paragraph (i)(A)(*3*) of this *Example 5*, X's basis in Asset 1 is $700.

(D) *Basis in other property.* A's basis in the X stock is $800 under sections 358(a), 358(d)(2), and 358(h)(2)(A).

(E) *Section 362(e)(2)(C) election.* The facts are the same as in paragraph (ii)(A) of this *Example 5,* except that A and X make an election under section 362(e)(2)(C). In this case, A's $100 net built-in loss that would have applied to reduce X's basis in Asset 1 is applied to reduce A's basis in the X stock received. As a result, A's basis in the X stock is $700 ($800, as determined in paragraph (ii)(D) of this *Example 5*, reduced by $100). X's basis in Asset 1 is $800.

Example 6. Section 351 transfer with boot. (i) *Basic transaction*-(A) *Facts.* A owns Asset 1 (basis $80, value $100) and Asset 2 (basis $30, value $25). In a transaction to which section 351 applies, A transfers Asset 1 and Asset 2 to X in exchange for 10 shares of X stock and $25.

(B) *Analysis—*(*1*) *Loss duplication transaction.* A's transfer of Asset 1 and Asset 2 is a section 362(a) transaction. But for section 362(e)(2) and this section, X's aggregate basis in those assets would be $130, computed as follows. Under section 362(a), a corporation's basis in property acquired in a transaction to which section 351 applies is the same as the property's basis in the hands of the transferor, increased by any gain recognized to the transferor on such transfer. Under section 351(b), gain (but not loss) is recognized to the extent a transferor in a section 351 exchange receives other property or money in addition to the stock permitted to be received without the recognition of gain. To determine the amount of gain recognized under section 351(b), the consideration is allocated proportionately (by value) among the transferred properties. A's gain on the transfer is therefore computed as follows: Asset 1 reflects 80 percent of the value transferred ($100/$125) and Asset 2 reflects 20 percent of the value transferred ($25/$125). Thus, 80 percent of the stock (eight shares) and the cash ($20) are treated as being received in exchange for Asset 1 and 20 percent of the stock (two shares) and the cash ($5) are treated as being received in exchange for Asset 2. Thus, under section 351(b), A recognizes $20 of gain for the cash received in exchange for Asset 1, but A recognizes no loss for the amount received for Asset 2. As a result, under section 362(a), X would have a basis of $100 in Asset 1 and $30 in Asset 2. Thus, X's aggregate basis in the assets would be $130, which exceeds the $125 aggregate value of the assets ($100 + $25)). The transfer is a loss duplication transaction and A has a net built-in loss of $5 ($130 − $125).

(*2*) *Identifying loss duplication property.* But for section 362(e)(2) and this section, X's basis in Asset 1 would be $100 (A's $80 basis increased by A's $20 gain recognized), which would not exceed Asset 1's $100 value immediately after the transaction. Accordingly, Asset 1 is not loss duplication property. But for section 362(e)(2) and this section, X's basis in Asset 2 would be $30, which would exceed Asset 2's $25 value immediately after the transaction. Accordingly, Asset 2 is loss duplication property.

(C) *Basis in loss duplication property.* X's basis in Asset 2 is $25, computed as its $30 basis under section 362(a) reduced by A's $5 net built-in loss.

(D) *Basis in other property.* Under section 362(a), X's basis in Asset 1 is $100 (A's $80 basis increased by the $20 gain recognized). Under section 358, A's basis in the X stock is $105 (the sum of its $80 basis in Asset 1, its $30 basis in Asset 2, and its $20 gain recognized, reduced by the $25 cash received in the exchange).

(ii) *Section 362(e)(2)(C) election.* The facts are the same as in paragraph (i)(A) of this *Example 6*, except that A and X elect to reduce A's stock basis under section 362(e)(2)(C). Under paragraph (d)(2)(i) of this section, A reduces its $105 basis in the X stock by $5, the amount of A's net built-in loss of that would have been applied to reduce X's basis in Asset 2 had the section 362(e)(2)(C) election not been made. As a result, A's basis in the X stock is $100, and X's basis in Asset 2 is $30.

Example 7. Section 304 sale of built-in loss stock. (i) *Basic transaction*—(A) *Facts.* A owns all the stock of X (basis $90, value $60) and all the stock of Y. A sells all his X stock to Y for $60. Under section 304, A is treated as though he transferred the X stock to Y in exchange for Y stock in a transaction to which section 351 applies. Then, Y is treated as redeeming the Y stock it was treated as having

issued to A in the deemed section 351 transaction.

(B) *Analysis—(1) Loss duplication transaction.* A's deemed transfer of X stock to Y is a section 362(a) transaction. But for section 362(e)(2) and this section, Y's aggregate basis in the X stock would be $90, which would exceed the X stock's value of $60 immediately after the transaction. Accordingly, the transfer is a loss duplication transaction and A has a net built-in loss of $30.

(*2*) *Identifying loss duplication property.* But for section 362(e)(2) and this section, Y's basis in the X stock would be $90, which would exceed the X stock's $60 value immediately after the transaction. Accordingly, the X stock is loss duplication property.

(C) *Basis in loss duplication property.* Y's basis in the X stock is $60, its $90 basis determined without regard to section 362(e)(2) and this section, reduced by A's $30 net built-in loss.

(D) *Basis in other property.* Under section 358(a), A has an exchanged basis of $90 in the Y stock he is deemed to receive in the exchange; the effect of the deemed redemption of that stock is then determined under section 302.

(ii) *Section 362(e)(2)(C) election.* The facts are the same as in paragraph (i)(A) of this *Example 7,* except that the parties elect to reduce A's stock basis under section 362(e)(2)(C). For the reasons set forth in paragraphs (i)(B) and (C) of this *Example 7,* Y's basis in the X stock would be reduced by $30. Accordingly, A's basis in the deemed-issued Y stock is $60, his $90 basis otherwise determined under section 358(a) reduced by the $30 that would have been applied to reduce Y's basis in the X stock under section 362(e)(2) and this section; the effect of the deemed redemption of that stock is then determined under section 302. Y's basis in the X stock is $90.

Example 8. Transactions involving partnerships. (i) *Transfer by a partnership*—(A) *Basic application of section—(1) Facts.* PRS owns Asset 1 (basis $100, value $70). PRS contributes Asset 1 to X in a transaction to which section 351 applies.

(*2*) *Analysis—(i) Loss duplication transaction.* PRS's transfer of Asset 1 is a section 362(a) transaction. But for section 362(e)(2) and this section, X's basis in Asset 1 would be $100, which would exceed Asset 1's $70 value immediately after the transaction. Accordingly, the transfer is a loss duplication transaction and PRS has a net built-in loss of $30 ($100 − $70).

(*ii*) *Identifying loss duplication property.* But for section 362(e)(2) and this section, X's basis in Asset 1 would be $100, which would exceed Asset 1's $70 value immediately after the transaction. Accordingly, Asset 1 is loss duplication property.

(*3*) *Basis in loss duplication property.* X's basis in Asset 1 is $70, computed as its $100 basis under section 362(a) reduced by PRS's $30 net built-in loss.

(*4*) *Basis in other property.* Under section 358(a), PRS has an exchanged basis of $100 in the X stock it receives in the exchange.

(B) *Section 362(e)(2)(C) election.* The facts are the same as in paragraph (i)(A)(*1*) of this *Example 8,* except that PRS and X elect to reduce PRS's stock basis under section 362(e)(2)(C). In this case, PRS's $30 net built-in loss (as determined in paragraph (i)(A)(*2*)(*i*) of this *Example 8*) that would have been applied to reduce X's basis in Asset 1 is applied to reduce PRS's basis in the X stock received. As a result, PRS's basis in the X stock is $70 ($100 − $30) and X's basis in Asset 1 is $100. The $30 reduction to PRS's basis in the X stock is treated as an expenditure of PRS under section 705(a)(2)(B) and paragraph (e)(1) of this section. As a result, the partners of PRS must reduce their bases in their PRS interests.

(ii) *Transfer of interest in partnership with liability*—(A) *Basic application of section—(1) Facts.* A and two other individuals are equal partners in PRS. A's basis in its partnership interest is $247. A's share of PRS's §1.752–1 liabilities (as defined in §1.752–1(a)(4)) is $145. A transfers his partnership interest to X in a transaction to which section 351 applies. PRS has no election in effect under section 754. If X were to sell the PRS interest immediately after the transfer, X would receive $100 in cash or other property. In addition, assume that, taking into account the rules under §1.752–4, X's share of PRS's §1.752–1 liabilities (as defined in §1.752–1(a)(4)) is $150 immediately after the transfer.

(*2*) *Analysis—(i) Loss duplication transaction.* A's transfer of its PRS interest is a section 362(a) transaction. But for section 362(e)(2) and this section, X's basis in the PRS interest, would be $252 (A's basis of $247, reduced by A's $145 share of PRS liabilities, increased by X's $150 share of PRS liabilities) and, under paragraph (g)(12)(ii) of this section, the value of the PRS interest would be $250 (the sum of $100, the cash X would receive if X immediately sold the interest, and $150, X's share of the §1.752–1 liabilities (as defined in §1.752–1(a)(4)) under section 752 immediately after the transfer to X). Therefore, the transfer is a loss duplication transaction and A has a net built-in loss of $2 ($252 − $250).

(*ii*) *Identifying loss duplication property.* But for section 362(e)(2) and this section, X's basis in the PRS interest would be $252, which would exceed the PRS interest's $250 value immediately after the transaction. Accordingly, the PRS interest is loss duplication property.

(*3*) *Basis in loss duplication property.* X's basis in the PRS interest is $250, computed as its $252 basis under section 362(a), taking into account the rules under section 752, reduced by A's $2 net built-in loss.

(*4*) *Basis in other property.* Under section 358, taking into account the rules under section 752, A has a basis of $102 ($247 reduced by A's $145 share of PRS liabilities) in the X stock he receives in the transaction.

(B) *Section 362(e)(2)(C) election.* The facts are the same as in paragraph (i)(A) of this *Example 8,* except that A and X make an election under section 362(e)(2)(C). Under paragraph (d)(2)(i) of this section, A reduces his basis in the X stock, as determined without regard to section 362(e)(2) and this section, by the amount of A's net built-in loss that would have been applied to reduce X's basis in the PRS interest had the section 362(e)(2)(C) election not been made. In addition, no reduction is made to X's basis in the PRS interest, as determined without regard to section 362(e)(2) and this section. As a result, A's basis in the X stock is $100 ($102 − $2) and X's basis in the PRS interest is $252.

(C) *Transfer of partnership interest with liability, not loss duplication transaction.* The facts are the same as in paragraph (ii)(A)(1) of this *Example 8,* except that A's share of PRS's §1.752–1 liabilities (as defined in §1.752–1(a)(4)) is $155. But for section 362(e)(2) and this section, X's basis in the PRS interest would be $242 (A's basis of $247, reduced by A's $155 share of PRS liabilities, increased by X's $150 share of PRS liabilities), which would not exceed the PRS interest's $250 value immediately after the transaction. Accordingly, A's transfer of the PRS interest is not a loss duplication transaction and section 362(e)(2) and this section have no application to the transaction. Under section 362(a), X's basis in the PRS interest is $242 and, under section 358, taking into account the rules under section 752, A has a basis of $92 ($247 reduced by A's $155 share of PRS liabilities) in the X stock he receives in the transaction.

Example 9. Transactions involving S Corporations. (i) *Transfer by S Corporation*—(A) *No section 362(e)(2)(C) election—*(*1*) *Facts.* S, an S corporation as defined in section 1361(a)(1), owns Asset 1 (basis $100, value $70). S transfers Asset 1 to X in exchange for a single outstanding share of X stock representing all the outstanding X stock immediately after the transaction. S does not elect to treat X as a qualified subchapter S subsidiary. The transaction is one to which section 351 applies.

(*2*) *Analysis—*(*i*) *Loss duplication transaction.* S's transfer of Asset 1 is a section 362(a) transaction. But for section 362(e)(2) and this section, X's basis in Asset 1 would be $100, which would exceed Asset 1's $70 value immediately after the transaction. Accordingly, the transfer is a loss duplication transaction and S has a net built-in loss of $30 ($100 − $70).

(*ii*) *Identifying loss duplication property.* But for section 362(e)(2) and this section, X's basis in Asset 1 would be $100, which would exceed Asset 1's $70 value immediately after the transaction. Accordingly, Asset 1 is loss duplication property.

(*iii*) *Basis in loss duplication property.* X's basis in Asset 1 is $70, computed as its $100 basis under section 362(a) reduced by S's $30 net built-in loss.

(*iv*) *Basis in other property.* Under section 358(a), S has an exchanged basis of $100 in the X stock it receives in the exchange.

(B) *Section 362(e)(2)(C) election.* The facts are the same as in paragraph (i)(A)(*1*) of this *Example 9,* except that S and X elect to reduce S's stock basis under section 362(e)(2). In this case, S's $30 built-in loss (as determined in paragraph (i)(A)(*2*)(*i*) of this *Example 9*) that would have been applied to reduce X's basis in Asset 1 is applied to reduce S's basis in the X stock received. As a result, S's basis in the X stock is $70 ($100 − $30) and X's basis in Asset 1 is $100. The $30 reduction to S's basis in the X stock is treated as an expense of S under section 1367(a)(2)(D) and paragraph (e)(2) of this section. As a result, the shareholders of S must reduce their bases in their S stock.

(ii) *Transfer to S Corporation*—(A) *Basic application of section.* (*1*) *Facts.* A owns Asset 1 (basis $90, value $60) and Asset 2 (basis $110, value $120). In a transaction to which section 351 applies, A transfers Asset 1 and Asset 2 to S, an S corporation as defined in section 1361(a)(1), in exchange for a single share of S stock representing all the outstanding S stock immediately after the transaction.

(*2*) *Analysis—*(*i*) *Loss duplication transaction.* A's transfer of Asset 1 and Asset 2 is a section 362(a) transaction. But for section 362(e)(2) and this section, S's aggregate basis in those assets would be $200 ($90 + $110), which would exceed the aggregate value of the assets $180 ($60 + $120) immediately after the transaction. Accordingly, the transfer is a loss duplication transaction and A has a net built-in loss of $20 ($200 − $180).

(*ii*) *Identifying loss duplication property.* But for section 362(e)(2) and this section, S's basis in Asset 1 would be $90, which would exceed Asset 1's $60 value immediately after the transaction. As a result, Asset 1 is loss duplication property. But for section 362(e)(2) and this section, S's basis in Asset 2 would be $110, which would not exceed Asset 2's $120 value immediately after the transaction. As a result, Asset 2 is not loss duplication property.

(*3*) *Basis in loss duplication property.* S's basis in Asset 1 is $70, computed as its $90 basis under section 362(a) reduced by S's $20 net built-in loss. The $20 reduction to S's basis in Asset 1 does not require a reduction to A's basis in its S stock under section 1367(a)(2)(D). See paragraph (f) of this section.

(*4*) *Basis in other property.* Under section 362(a), S has a transferred basis of $110 in Asset 2. Under section 358(a), A has a basis of

$200 in the S stock it receives in the exchange.

(B) *Section 362(e)(2)(C) election—(1) Application of section to transaction.* The facts are the same as in paragraph (ii)(A)(*1*) of this *Example 9*, except that A and S elect to reduce A's stock basis under section 362(e)(2)(C). In this case, A's $20 built-in loss (as determined in paragraph (ii)(A)(*2*) of this *Example 9*) that would have been applied to reduce S's basis in Asset 1 is applied to reduce A's basis in the S stock received. As a result, A's basis in the S stock is $180 ($200 − $20), S's basis in Asset 1 is $90, and S's basis in Asset 2 is $110.

(*2*) *Tax consequences of subsequent disposition of transferred assets.* The facts are the same as in paragraph (ii)(B)(*1*) of this *Example 9* except that, in addition, the year after the transaction, S sells Asset 1 (basis $90, value $60) and Asset 2 (basis $110, value $120) for $180, recognizing the $20 net built-in loss. The loss is allocated to A and reduces A's basis in the S stock from $180 to $160 under section 1367(a)(2)(B). If A then sells its S stock for its $180 value, A will recognize a gain of $20.

Example 10. Triangular reorganizations. (i) *Facts.* P owns all the stock of S1 and X owns all the stock of S2. In a merger described in section 368(a)(2)(D), S2 merges with and into S1, and X receives stock of P in exchange for its S2 stock. S2 has a net built-in loss in its assets acquired by S1 in the transaction.

(ii) *Analysis.* The reorganization is not a section 362(a) transaction, notwithstanding that, under §1.358–6(c), P is treated as acquiring and then transferring S2's assets to S1 for purposes of determining P's adjustment to its basis in its S1 stock. Accordingly, S1's basis in the property acquired in the transaction is not determined under section 362(e)(2) and this section; it is determined under section 362(b).

Example 11. Transfers of importation property with non-importation property. (*i*) *Single transferor, loss importation transaction.* (A) *Facts.* FC1 transfers Asset 1 (basis $80, value $50), Asset 2 (basis $120, value $110), and Asset 3 (basis $32, value $40) to DC in a transaction to which section 351 applies. Asset 1 is not importation property within the meaning of §1.362–3(c)(2). Asset 2 and Asset 3 are importation property within the meaning of §1.362–3(c)(2).

(B) *Application of section 362(e)(1).* Immediately after the transfer, and without regard to section 362(e)(1) or section 362(e)(2) and this section, DC's aggregate basis in importation property (Asset 2 and Asset 3) would be $152. The aggregate value of the importation property immediately after the transfer is $150. Accordingly, the transaction is a loss importation transaction within the meaning of §1.362–3(c)(3) and, under section 362(e)(1), DC's bases in Asset 2 and Asset 3 would equal the value of each, $110 and $40, respectively.

(C) *Application of section 362(e)(2) and this section.* (*1*) *Analysis.* (*i*) *Loss duplication transaction.* FC1's transfer of Asset 1, Asset 2, and Asset 3 is a transaction described in section 362(a). But for section 362(e)(2) and this section, DC's aggregate basis in those assets would be $230 ($80 under section 362(a) + $110 + $40 under section 362(e)(1)), which would exceed the aggregate value of the assets $200 ($50 + $110 + 40) immediately after the transaction. Accordingly, the transfer is a loss duplication transaction and FC1 has a net built-in loss of $30 ($230 − $200).

(*ii*) *Identifying loss duplication property.* But for section 362(e)(2) and this section, DC's basis in Asset 1 would be $80, which would exceed Asset 1's $50 value immediately after the transaction. Accordingly, Asset 1 is loss duplication property. But for section 362(e)(2) and this section, DC's basis in Asset 2 would be $110, which would not exceed Asset 2's $110 value immediately after the transaction. Accordingly, Asset 2 is not loss duplication property. But for section 362(e)(2) and this section, DC's basis in Asset 3 would be $40, which would not exceed Asset 3's $40 value immediately after the transaction. Accordingly, Asset 3 is not loss duplication property.

(D) *Basis in loss duplication property.* DC's basis in Asset 1 is $50, computed as its $80 basis under section 362(a) reduced by FC1's $30 net built-in loss.

(E) *Basis in other property.* Under section 362(e)(1), DC's basis in Asset 2 is $110 and DC's basis in Asset 3 is $40. Under section 358(a), FC1 has an exchanged basis of $232 in the DC stock it receives in the transaction.

(ii) *Multiple transferors, no importation of loss.* (A) *Facts.* The facts are the same as paragraph (i)(A) of this *Example 11*, except that, in addition, FC2 transfers Asset 4 (basis $100, value $150) to DC as part of the same transaction. Asset 4 is importation property within the meaning of §1.362–3(c)(2).

(B) *Application of section 362(e)(1).* Immediately after the transfer, and without regard to section 362(e)(1) or section 362(e)(2) and this section, DC's aggregate basis in importation property (Asset 2, Asset 3, and Asset 4) would be $252 ($120 + $32 + $100). The aggregate value of the importation property immediately after the transfer is $300 ($110 + $40 + $150). Accordingly, the transaction is not a loss importation transaction within the meaning of §1.362–3(c)(3) and DC's bases in the importation property is not determined under section 362(e)(1).

(C) *Application of section 362(e)(2) and this section.* Notwithstanding that the transfers by FC1 and FC2 are pursuant to a single plan forming one transaction, section 362(e)(2) and this section apply to each transferor separately.

(*1*) *Application of section to FC1.* (*i*) *Loss duplication transaction.* FC1's transfer of Asset

1, Asset 2, and Asset 3 is a transaction described in section 362(a). But for section 362(e)(2) and this section, DC's aggregate basis in those assets would be $232 ($80 + $120 + $32), which would exceed the aggregate value of the assets $200 ($50 + $110 + $40) immediately after the transaction. Accordingly, the transfer is a loss duplication transaction and FC1 has a net built-in loss of $32 ($232 − $200).

(*ii*) *Identifying loss duplication property.* But for section 362(e)(2) and this section, DC's basis in Asset 1 would be $80, which would exceed Asset 1's $50 value immediately after the transaction. Accordingly, Asset 1 is loss duplication property. But for section 362(e)(2) and this section, DC's basis in Asset 2 would be $120, which would exceed Asset 2's $110 value immediately after the transaction. Accordingly, Asset 2 is also loss duplication property. But for section 362(e)(2) and this section, DC's basis in Asset 3 would be $32, which would not exceed Asset 3's $40 value immediately after the transaction. Accordingly, Asset 3 is not loss duplication property.

(*iii*) *Basis in loss duplication property.* DC's basis in Asset 1 is $56, computed as its $80 basis under section 362(a) reduced by $24, its allocable portion of FC1's $32 net built-in loss ($30/40 × $32). DC's basis in Asset 2 is $112, computed as its $120 basis under section 362(a) reduced by $8, its allocable portion of FC1's $40 net built-in loss ($10/$40 × $32).

(*iv*) *Basis in other property.* Under section 358(a), FC1 has an exchanged basis of $232 in the DC stock it receives in the transaction.

(*2*) *Application of section to FC2.* FC2's transfer of Asset 3 is not a loss duplication transaction because Asset 3's value exceeds its basis immediately after the transaction. Accordingly, under section 362(a), DC's basis in Asset 3 is $100.

Example 12. Section 362(e)(2)(C) elections with respect to transfers between persons that are not required to file a U.S. return and that are not CFCs or CFPs—(i) *Basic application of section.* On June 30, Year 1, FC1 transfers Asset 1 to FC2 in a transaction to which section 351 applies (the original transfer) and that is therefore a section 362(a) transaction. But for section 362(e)(2) and this section, FC2's basis in Asset 1 (determined immediately after the transfer, taking into account all applicable law, including section 362(e)(1)) exceeds the value of Asset 1 immediately after the transaction. Accordingly, the transaction is a loss duplication transaction and Asset 1 is loss duplication property. FC1 and FC2 executed a written, binding agreement to apply section 362(e)(2)(C) at some point before any Section 362(e)(2)(C) Statement is filed. However, the transfer was not entered into with a view to reducing or avoiding the Federal income tax liability of any person by avoiding the application of section 362(e)(2) and this section; further, no event described in paragraph (d)(3)(ii)(E), (F), or (G) of this section occurs prior to June 30, Year 3. As a result, under paragraph (c)(2) of this section, section 362(e)(2) and this section do not apply to the transfer. Accordingly, FC2's basis in Asset 1 is determined under section 362(a), no section 362(e)(2)(C) election can be made, and any protective filing of a Section 362(e)(2)(C) Statement will have no effect.

(ii) *Loss duplication property later acquired by a person required to file U.S. return.* The facts are the same as in paragraph (i) of this *Example 12,* except that, in addition, on January 1, Year 2, FC2 transfers Asset 1 to DC in an exchange to which section 351 applies. FC2's transfer is an event described in paragraph (d)(3)(ii)(G) of this section. As a result, paragraph (c)(2) does not except the original transfer from the application of section 362(e)(2) and this section. Under paragraph (d)(3)(ii)(G) of this section, DC must include the Section 362(e)(2)(C) Statement for the original transfer on or with its Year 2 U.S. return in order for that election to be effective. The result would be the same if, instead of FC2 transferring Asset 1 to DC, FC1 transferred its FC2 stock to DC in an exchange to which section 351 applies. (Further, if an asset transferred by FC1 or FC2 to DC is a loss asset immediately after its transfer to DC, DC's basis in that asset may be subject to section 362(e)(1).)

(iii) *Party to exchange later becomes a person required to file U.S. return.* The facts are the same as in paragraph (i) of this *Example 12,* except that, in addition, on January 1, Year 2, FC2 becomes engaged in a U.S. business. FC2's becoming engaged in a U.S. business is an event described in paragraph (d)(3)(ii)(F) of this section because it will cause FC2 to become a person required to file a U.S. return. As a result, paragraph (c)(2) of this section does not except the transfer from the application of section 362(e)(2) and this section. Under paragraph (d)(3)(ii)(F) of this section, FC2 must include the Section 362(e)(2)(C) Statement for the original transfer on or with its Year 2 U.S. return in order for the section 362(e)(2)(C) election for the original transfer to be effective.

(iv) *Statement not filed with respect to designated event.* The facts are the same as in paragraph (iii) of this *Example 12,* except that, in addition, FC1 became engaged in a U.S. trade or business on October 31, Year 1 and as a result became a person required to file a U.S. return, an event described in paragraph (d)(3)(ii)(E) of this section. As a result, paragraph (c)(2) of this section does not except the transfer from the application of section 362(e)(2) and this section. Further, in order for the election to be effective, FC1 must file the Section 362(e)(2)(C) Statement on or with its Year 1 U.S. return. See paragraph (d)(3)(ii)(E) of this section. A statement filed by FC2 on or with its Year 2 U.S. return has no effect. Thus, if FC1 does not

file the statement, the election does not become effective and basis is determined under the general rule of section 362(e)(2).

(v) *Nonrecognition transfer of loss duplication property outside United States, transferee later becomes engaged in U.S. trade or business.* The facts are the same as in paragraph (i) of this *Example 12*, except that, in addition, on December 31, Year 1, FC2 transfers Asset 1 to FC3 in a transferred basis transaction. In Year 2, FC3 becomes engaged in a U.S. trade or business and as a result becomes a person required to file a U.S. return; Asset 1 is not used in or connected with the U.S. trade or business or otherwise subject to Federal income tax. FC3's becoming engaged in a U.S. trade or business is an event described in paragraph (d)(3)(ii)(F) of this section because FC3, a person who holds loss duplication property with a basis determined by FC2's basis in the property, will be required to file a U.S. return as a result of its becoming engaged in a U.S. business. As a result, paragraph (c)(2) of this section does not except the transfer from the application of section 362(e)(2) and this section. Under paragraph (d)(3)(ii)(F) of this section, FC3 must include the Section 362(e)(2)(C) Statement for the original transfer on or with its Year 2 U.S. return in order for the section 362(e)(2)(C) election for the original transfer to be effective.

(i) [Reserved]

(j) *Effective/applicability date.* * * * The introductory text and *Example 11* of paragraph (h) of this section apply with respect to transactions occurring on or after *March 28, 2016*, and also with respect to transactions occurring before such date as a result of an entity classification election under §301.7701–3 of this chapter filed on or after *March 28, 2016*, unless such transaction is pursuant to a binding agreement that was in effect prior to *March 28, 2016* and at all times thereafter. In addition, taxpayers may apply such provisions to any transaction occurring after October 22, 2004.

[T.D. 9424, 73 FR 53948, Sept. 17, 2008, as amended by T.D. 9633, 78 FR 54160, Sept. 3, 2013; T.D. 9759, 81 FR 17082, Mar. 28, 2016]

§ 1.367(a)–1 Transfers to foreign corporations subject to section 367(a): In general.

(a) through (b)(4)(i)(A) [Reserved] For further guidance see §1.367(a)–1T(a) through (b)(4)(i)(A).

(B) Appropriate adjustments to earnings and profits, basis, and other affected items will be made according to otherwise applicable rules, taking into account the gain recognized under section 367(a)(1). For purposes of applying section 362, the foreign corporation's basis in the property received is increased by the amount of gain recognized by the U.S. transferor under section 367(a) and the regulations issued pursuant to that section. To the extent the regulations provide that the U.S. transferor recognizes gain with respect to a particular item of property, the foreign corporation increases its basis in that item of property by the amount of such gain recognized. For example, §§1.367(a)–3, 1.367(a)–4T, and 1.367(a)–5T provide that gain is recognized with respect to particular items of property. To the extent the regulations do not provide that gain recognized by the U.S. transferor is with respect to a particular item of property, such gain is treated as recognized with respect to items of property subject to section 367(a) in proportion to the U.S. transferor's gain realized in such property, after taking into account gain recognized with respect to particular items of property transferred under any other provision of section 367(a). For example, §1.367(a)–6T provides that branch losses must be recaptured by the recognition of gain realized on the transfer but does not associate the gain with particular items of property. See also §1.367(a)–1T(c)(3) for rules concerning transfers by partnerships or of partnership interests.

(C) The transfer will not be recharacterized for U.S. Federal tax purposes solely because the U.S. person recognizes gain in connection with the transfer under section 367(a)(1). For example, if a U.S. person transfers appreciated stock or securities to a foreign corporation in an exchange described in section 351, the transfer is not recharacterized as other than an exchange described in section 351 solely because the U.S. person recognizes gain in the transfer under section 367(a)(1).

(b)(4)(ii) through (d)(2) [Reserved] For further guidance see §1.367(a)–1T(b)(4)(ii) through (d)(2).

(3) *Transfer.* For purposes of section 367 and regulations thereunder, the term ''transfer'' means any transaction that constitutes a transfer for purposes of section 332, 351, 354, 355, 356, or 361,

as applicable. A person's entering into a cost sharing arrangement under §1.482–7 or acquiring rights to intangible property under such an arrangement shall not be considered a transfer of property described in section 367(a)(1). See §1.6038B–1T(b)(4) for the date on which the transfer is considered to be made.

(4) through (5) [Reserved]. For further guidance, *see* §1.367(a)–1T(d)(4) through (5).

(e) *Close of taxable year in certain section 368(a)(1)(F) reorganizations.* If a domestic corporation is the transferor corporation in a reorganization described in section 368(a)(1)(F) after March 30, 1987, in which the acquiring corporation is a foreign corporation, then the taxable year of the transferor corporation shall end with the close of the date of the transfer and the taxable year of the acquiring corporation shall end with the close of the date on which the transferor's taxable year would have ended but for the occurrence of the transfer. With regard to the consequences of the closing of the taxable year, *see* section 381 and the regulations thereunder.

(f) *Exchanges under sections 354(a) and 361(a) in certain section 368(a)(1)(F) reorganizations*—(1) *Rule.* In every reorganization under section 368(a)(1)(F), where the transferor corporation is a domestic corporation, and the acquiring corporation is a foreign corporation, there is considered to exist—

(i) A transfer of assets by the transferor corporation to the acquiring corporation under section 361(a) in exchange for stock (or stock and securities) of the acquiring corporation and the assumption by the acquiring corporation of the transferor corporation's liabilities;

(ii) A distribution of the stock (or stock and securities) of the acquiring corporation by the transferor corporation to the shareholders (or shareholders and security holders) of the transferor corporation; and

(iii) An exchange by the transferor corporation's shareholders (or shareholders and security holders) of their stock (or stock and securities) of the transferor corporation for stock (or stock and securities) of the acquiring corporation under section 354(a).

(2) *Rule applies regardless of whether a continuance under applicable law.* For purposes of paragraph (f)(1) of this section, it shall be immaterial that the applicable foreign or domestic law treats the acquiring corporation as a continuance of the transferor corporation.

(g)(1) through (3) [Reserved]. For further guidance, *see* §1.367(a)–1T(g)(1) through (3).

(4) The rules in paragraphs (b)(4)(i)(B) and (b)(4)(i)(C) of this section apply to transfers occurring on or after April 18, 2013. For guidance with respect to paragraph (b)(4)(i)(B) of this section before April 18, 2013, see 26 CFR part 1 revised as of April 1, 2012. The rules in paragraph (e) of this section apply to transactions occurring on or after March 31, 1987. The rules in paragraph (f) of this section apply to transactions occurring on or after January 1, 1985.

[T.D. 9441, 74 FR 348, Jan. 5, 2009, as amended by T.D. 9568, 76 FR 80087, Dec. 22, 2011; T.D. 9614, 78 FR 17030, Mar. 19, 2013; T.D. 9739, 80 FR 56192, Sept. 21, 2015]

§1.367(a)–1T Transfers to foreign corporations subject to section 367(a): In general (temporary).

(a) *Purpose and scope of regulations.* These regulations set forth rules relating to the provisions of section 367(a) concerning certain transfers of property to foreign corportions. This section provides general rules explaining the effect of section 367(a)(1) and describing the transfers of property that are subject to the rule of that section. Section 1.367(a)–2T provides rules concerning the exception from the rule of section 367(a)(1) for transfers of property to be used in the active conduct of a trade or business outside of the United States. Rules concerning the application of section 367(a)(1) to transfers of stock or securities are provided in §1.367(a)–3, while §1.367(a)–4T provides special rules regarding other specified transfers of property. Section 1.367(a)–5T describes types of property that are subject to the rule of section 367(a)(1) regardless of whether they are transferred for use in a trade or business. Section 1.367(a)–6T provides rules concerning the application of section 367(a) to the transfer of a branch with previously deducted losses. Finally,

§1.367(a)–7T contains transitional rules concerning transfers of intangible property to foreign corporations made after June 6, 1984 and before January 1, 1985. Rules explaining the operation of section 367(d), concerning transfers of intangible property pursuant to an exchange described in section 351 or 361, are provided in §1.367(d)–1T. Rules concerning the reporting requirements of section 6038B are provided in §§1.6038B–1 and 1.6038B–1T.

(b) *General rules*—(1) *Foreign corporation not considered a corporation for purposes of certain transfers.* If a U.S. person transfers property to a foreign corporation in connection with an exchange described in section 332, 351, 354, 355, 356, or 361, then pursuant to section 367(a)(1) the foreign corporation shall not be considered to be a corporation for purposes of determining the extent to which gain shall be recognized on the transfer. Section 367(a)(1) denies nonrecognition treatment only to transfers of items of property on which gain is realized. Thus, the amount of gain recognized because of section 367(a)(1) is unaffected by the transfer of items of property on which loss is realized (but not recognized). The transfers of property that are subject to section 367(a)(1) are further described in paragraph (c) of this section, and relevant definitions are provided in paragraph (d) of this section.

(2) *Cases in which foreign corporate status is not disregarded.* Section 367(a)(1) shall not apply, and a foreign corporate transferee shall, thus, be considered to be a corporation, in the case of any of the following:

(i) [Reserved]

(ii) The transfer of property for use in the active conduct of a trade or business outside of the United States in accordance with the rules of §§1.367(a)-2T through 1.367(a)-6T; or

(iii) Certain other transfers of property described in §§1.367(a)-2T through 1.367(a)-6T.

(3) *Limitation of gain required to be recognized*—(i) *In general.* If a U.S. person transfers property to a foreign corporation in a transaction on which gain is required to be recognized under section 367(a) and regulations thereunder, then the gain required to be recognized by the U.S. person shall in no event exceed the gain that would have been recognized on a taxable sale of those items of property if sold individually and without offsetting individual losses against individual gains.

(ii) *Losses.* No loss may be recognized by reason of the operation of section 367.

(iii) *Ordinary income and capital gain.* If section 367(a) and regulations thereunder require the recognition of ordinary income and capital gain in excess of the limitation described in paragraph (b)(3)(i) of this section, then the limitation shall be imposed by making proportionate reductions in the amounts or ordinary income and capital gain, regardless of the character of the gain that would have been recognized on a taxable sale of the property.

(4) *Character, source, and adjustments*—(i) *In general.* If a U.S. person is required to recognize gain under section 367 upon a transfer of property to a foreign corporation, then—

(A) The character and source of such gain shall be determined as if the property had been disposed of in a taxable exchange with the transferee foreign corporation (unless otherwise provided by regulation); and

(B) [Reserved] For further guidance see §1.367(a)–1(b)(4)(i)(B).

(C) [Reserved] For further guidance see §1.367(a)–1(b)(4)(i)(C).

(ii) *Example.* The rules of this paragraph (b)(4) are illustrated by the following example.

Example. Domestic corporation DC transfers inventory with a fair market value of $1 million and adjusted basis of $800,000 to foreign corporation FC in an exchange for stock of FC that is described in section 351 (a). Title passes within the U.S. Pursuant to section 367(a), DC is required to recognize gain of $200,000 upon the transfer. Under the rule of this paragraph (b)(4), such gain shall be treated as ordinary income (sections 1201 and 1221) from sources within the U.S. (section 861) arising from a taxable exchange with FC. Appropriate adjustments to earnings and profits, basis, etc., shall be made as if the transfer were subject to section 351. Thus, for example, DC's basis in the FC stock received, and FC's basis in the transferred inventory, will each be increased by the $200,000 gain recognized by DC, pursuant to sections 358(a)(1) and 362(a), respectively.

(c) *Transfers described in section 367(a)(1)*—(1) *In general.* A transfer described in section 367(a)(1) is any transfer of property by a U.S. person to a foreign corporation pursuant to an exchange described in section 332, 351, 354, 355, 356, or 361. Section 367(a)(1) applies to such a transfer whether it is made directly, indirectly, or constructively. Indirect or constructive transfers that are described in section 367(a)(1) include the transfers described in subparagraphs (2) through (7) of this paragraph (c).

(2) *Indirect transfers in certain reorganizations.* [Reserved]. For further guidance, see §1.367(a)–3(d).

(3) *Indirect transfers involving partnerships and interests therein*—(i) *Transfer by partnership treated as transfer by partners*—(A) *In general.* If a partnership (whether foreign or domestic) transfers property to a foreign corporation in an exchange described in section 367(a)(1), then a U.S. person that is a partner in the partnership shall be treated as having transferred a proportionate share of the property in an exchange described in section 367(a)(1). A U.S. person's proportionate share of partnership property shall be determined under the rules and principles of sections 701 through 761 and the regulations thereunder. The rule of this paragraph (c)(3)(i)(A) is illustrated by the following example.

Example. P is a partnership having five equal general partners, two of whom are United States persons. P transfers property to F, a foreign corporation, in connection with an exchange described in section 351. The exchange includes an indirect transfer of property by the partners to F. The transfers of property attributable to those partners who are United States persons, that is, 40 percent of each asset transferred to F, are transfers described in section 367(a)(1). The gain (if any) recognized on the transfer of 40 percent of each asset to F is attributable to the two partners who are United States persons.

(B) *Special adjustments to basis.* If a U.S. person is treated under the rule of this paragraph (c)(3)(i) as having transferred a proportionate share of the property of a partnership in an exchange described in section 367(a), and is therefore required to recognize gain upon the transfer, then—

(*1*) The U.S. person's basis in the partnership shall be increased by the amount of gain recognized by him;

(*2*) Solely for purposes of determining the basis of the partnership in the stock of the transferee foreign corporation, the U.S. person shall be treated as having newly acquired an interest in the partnership (for an amount equal to the gain recognized), permitting the partnership to make an optional adjustment to basis pursuant to sections 743 and 754; and

(*3*) The transferee foreign corporation's basis in the property acquired from the partnership shall be increased by the amount of gain recognized by U.S. persons under this paragraph (c)(3)(i).

(ii) *Transfer of partnership interest treated as transfer of proportionate share of assets*—(A) *In general.* If a U.S. person transfers an interest as a partner in a partnership (whether foreign or domestic) in an exchange described in section 367(a)(1), then that person shall be treated as having transferred a proportionate share of the property of the partnership in an exchange described in section 367(a)(1). Accordingly, the applicability of the exception to section 367(a)(1) provided in §1.367(a)–2T shall be determined with reference to the property of the partnership rather than the partnership interest itself. A U.S. person's proportionate share of partnership property shall be determined under the rules and principles of sections 701 through 761 and the regulations thereunder.

(B) *Special adjustments to basis.* If a U.S. person is treated under the rule of paragraph (c)(3)(ii)(A) of this section as having transferred a proportionate share of the property of a partnership in an exchange described in section 367(a), and is therefore required to recognize gain upon the transfer, then—

(*1*) The U.S. person's basis in the stock of the transferee foreign corporation shall be increased by the amount of gain so recognized by that person;

(*2*) The transferee foreign corporation's basis in the transferred partnership interest shall be increased by the amount of gain recognized by the U.S. person; and

(*3*) Solely for purposes of determining the partnership's basis in the property

held by it, the U.S. person shall be treated as having newly acquired an interest in the partnership (for an amount equal to the gain recognized), permitting the partnership to make an optional adjustment to basis pursuant to sections 743 and 754.

(C) *Limited partnership interest.* The transfer by a U.S. person of an interest in a partnership shall not be subject to the rules of paragraph (c)(3)(ii)(A) and (B) if—

(*1*) The interest transferred is a limited partnership interest; and

(*2*) Such interest is regularly traded on an established securities market.

Instead, the transfer of such an interest shall be treated in the same manner as a transfer of stock or securities. Thus, the consequences of such a transfer shall be determined under the rules of §1.367(a)–3. For purposes of this section, a limited partnership interest is an interest as a limited partner in a partnership that is organized under the laws of any State of the United States or the District of Columbia. Whether such an interest is regularly traded on an established securities market shall be determined under the provisions of paragraph (c)(3)(ii)(D) of this section.

(D) *Regularly traded on an established securities market—(1) Established securities market.* For purposes of this paragraph (c)(3)(ii), an established securities market is—

(*i*) A national securities exchange which is registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f);

(*ii*) A foreign national securities exchange which is officially recognized, sanctioned, or supervised by governmental authority; and

(*iii*) An over-the-counter market. An over-the-counter market is any market reflected by the existence of an inter-dealer quotation system. An inter-dealer quotation system is any system of general circulation to brokers and dealers which regularly disseminates quotations of stock and securities by identified brokers or dealers, other than by quotation sheets which are prepared and distributed by a broker or dealer in the regular course of business and which contain only quotations of such broker or dealer.

(*2*) *Regularly traded.* A class of interests that is traded on an established securities market is considered to be regularly traded if it is regularly quoted by brokers or dealers making a market in such interests. A class of interests shall be presumed to be regularly traded if the entity has a total of 500 or more interest-holders.

(4) *Transfers by trusts and estates*—(i) *In general.* For purposes of section 367(a), a transfer of property by an estate or trust shall be treated as a transfer by the entity itself and not as an indirect transfer by its beneficiaries. Thus, a transfer of property by a foreign trust or estate (as defined in section 7701(a)(31)) is not described in section 367(a)(1), regardless of whether the beneficiaries of the trust or estate are U.S. persons. Similarly, a transfer of property by a domestic trust or estate may be described in section 367(a)(1), regardless of whether the beneficiaries of the trust or estate are foreign persons.

(ii) *Grantor trusts.* A transfer of a portion or all of the assets of a foreign or domestic trust to a foreign corporation in an exchange described in section 367(a)(1) is considered a transfer by any U.S. person who is treated as the owner of any such portion or all of the assets of the trust under sections 671 through 679.

(5) *Termination of election under section 1504(d).* Section 367(A) applies to the constructive reorganization and transfer of property from a domestic corporation to a foreign corporation that occurs upon the termination of an election under section 1504(d), which permits the treatment of certain contiguous country corporations as domestic corporations. The rule of this paragraph (c)(5) is illustrated by the following example.

Example. Domestic corporation Y previously made a valid election under section 1504(d) to have its wholly owned Canadian subsidiary, C, treated as a domestic corporation. On July, 1, 1986, C fails to continue to qualify for the election under section 1504 (d). A constructive reorganization described in section 368(a)(1)(D) occurs. The resulting constructive transfer of assets by ''domestic'' corporation C to Canadian corporation C upon the termination of the election is a transfer of property described in section 367(a)(1).

(6) *Changes in classification of an entity.* If a foreign entity is classified as an entity other than an association taxable as a corporation for United States tax purposes, and subsequently a change is made in the governing documents, articles, or agreements of the entity so that the entity is thereafter classified as an association taxable as a corporation, the change in classification is considered a transfer of property to a foreign corporation in connection with an exchange described in section 351. For purposes of section 367(a)(1), the transfer of property is considered as made by the persons determined under the rules set forth in paragraph (c)(3) of this section with respect to partnerships, and paragraph (c)(4)(i) or (ii), with respect to trusts and estates, and the rules of such paragraphs apply determining whether a transfer described in section 367(a)(1) has been made.

(7) *Contributions to capital.* For rules with respect to the treatment of a contribution to the capital of a foreign corporation as a transfer described in section 367(a)(1), see section 367(c)(2) and the regulations thereunder.

(d) *Definitions.* The following definitions apply for purposes of this section and §1.367(d)–1T.

(1) *United States person.* The term *United States person* includes those persons described in section 7701(a)(30). The term includes a citizen or resident of the United States, a domestic partnership, a domestic corporation, and any estate or trust other than a foreign estate or trust. (For definitions of these terms, see section 7701 and regulations thereunder.) For purposes of this section, an individual with respect to whom an election has been made under section 6013 (g) or (h) is considered to be a resident of the United States while such election is in effect. A nonresident alien or a foreign corporation will not be considered a United States person because of its actual or deemed conduct of a trade or business within the United States during a taxable year.

(2) *Foreign corporation.* The term *foreign corporation* has the meaning set forth in section 7701(a)(3) and (5) and §301.7701–5.

(3) [Reserved] For further guidance, see §1.367(a)–1(d)(3).

(4) *Property.* For purposes of section 367 and regulations thereunder, the term *property* means any item that constitutes property for purposes of sections 332, 351, 354, 355, 356, or 361, as applicable.

(5) *Intangible property*—(i) *In general.* For purposes of section 367 and regulations thereunder, the term *intangible property* means knowledge, rights, documents, and any other intangible item within the meaning of section 936(h)(3)(B) that constitutes property for purposes of sections 332, 351, 354, 355, 356, or 361, as applicable. Such property shall be treated as intangible property for purposes of section 367 (a) and (d) and the regulations thereunder without regard to whether it is used or developed in the United States or in a foreign country and without regard to whether it is used in manufacturing activities or in marketing activities. A working interest in oil and gas properties shall not be considered to be intangible property for purposes of section 367 and the regulations thereunder.

(ii) *Operating intangibles.* An operating intangible is any intangible property of a type not ordinarily licensed or otherwise transferred in transactions between unrelated parties for consideration contingent upon the licensee's or transferee's use of the property. Examples of operating intangibles may include long-term purchase or supply contracts, surveys, studies, and customer lists.

(iii) *Foreign goodwill or going concern value.* Foreign goodwill or going concern value is the residual value of a business operation conducted outside of the United States after all other tangible and intangible assets have been identified and valued. For purposes of section 367 and regulations thereunder the value of the right to use a corporate name in a foreign country shall be treated as foreign goodwill or going concern value.

(iv) *Transitional rule for certain marketing intangibles.* For transfers occurring after December 31, 1984, and before May 16, 1986, for foreign trademarks, tradenames, brandnames, and similar marketing intangibles developed by a

foreign branch shall be treated as foreign goodwill or going concern value.

(e) [Reserved]. For further guidance, *see* § 1.367(a)–1(e).

(f) [Reserved]. For further guidance, *see* § 1.367(a)–1(f).

(g) *Effective date of certain section—*

(1) *In general.* Except as specifically provided to the contrary elsewhere in these sections, §§ 1.367(a)–1T through 1.367(a)–6T apply to transfers occurring after December 31, 1984.

(2) *Private rulings.* The taxpayer may rely on a private ruling under section 367(a) received by him before June 16, 1986.

(3) *Certain indirect transfers.* Sections 1.367(a)–1T(c)(2)(i) and (iii) and 1.367(a)–1T(c)(3) apply to transfers made after June 16, 1986. For transfers made before that date, see 26 CFR 1.367(a)–1(b) (revised as of April 1, 1986).

(4) [Reserved] For further guidance see § 1.367(a)–1(g)(4).

[T.D. 8087, 51 FR 17938, May 16, 1986, as amended by T.D. 8280, 55 FR 1408, Jan. 16, 1990; T.D. 8770, 63 FR 33555, June 19, 1998; T.D. 9441, 74 FR 348, Jan. 5, 2009; T.D. 9568, 76 FR 80087, Dec. 22, 2011; T.D. 9614, 78 FR 17031, Mar. 19, 2013; T.D. 9739, 80 FR 56192, Sept. 21, 2015]

§ 1.367(a)–2 Exception for transfers of property for use in the active conduct of a trade or business.

(a) through (d) [Reserved] For further guidance, see § 1.367(a)–2T(a) through (d).

(e) *Special rules for certain transfers occurring on or after May 2, 2006—* (1) *General rule.* Whether a trade or business that produces rents or royalties is actively conducted shall be determined under the principles of section 954(c)(2)(A) and the regulations thereunder (but without regard to whether the rents or royalties are received from an unrelated party). See § 1.954–2(c) and (d).

(2) *Effective/applicability date.* The rules of this paragraph (e) apply to transfers occurring on or after May 2, 2006. However, if the transferor makes the election to apply the provisions of § 1.367(a)–4(c)(3) for transfers occurring on or after October 22, 2004, then paragraph (e)(1) of this section will also apply to the transfers occurring on or after October 22, 2004.

(f) *Failure to comply with reporting requirements of section 6038B*—(1) *Failure to comply.* For purposes of the exception to the application of section 367(a)(1) provided in paragraph (a) of § 1.367(a)–2T, a failure to comply with the reporting requirements of section 6038B and the regulations thereunder (failure to comply) has the meaning set forth in § 1.6038B–1(f)(2).

(2) *Relief for certain failures to comply that are not willful*—(i) *In general.* A failure to comply described in paragraph (f)(1) of this section will be deemed not to have occurred for purposes of satisfying the requirements of this section if the taxpayer demonstrates that the failure was not willful using the procedure set forth in this paragraph (f)(2). For this purpose, willful is to be interpreted consistent with the meaning of that term in the context of other civil penalties, which would include a failure due to gross negligence, reckless disregard, or willful neglect. Whether a failure to comply was a willful failure will be determined by the Director of Field Operations International, Large Business & International (or any successor to the roles and responsibilities of such position, as appropriate) (Director) based on all the facts and circumstances. The taxpayer must submit a request for relief and an explanation as provided in paragraph (f)(2)(ii)(A) of this section. Although a taxpayer whose failure to comply is determined not to be willful will not be subject to gain recognition under this section, the taxpayer will be subject to a penalty under section 6038B if the taxpayer fails to demonstrate that the failure was due to reasonable cause and not willful neglect. See § 1.6038B–1(b)(1) and (f). The determination of whether the failure to comply was willful under this section has no effect on any request for relief made under § 1.6038B–1(f).

(ii) *Procedures for establishing that a failure to comply was not willful*—(A) *Time and manner of submission.* A taxpayer's statement that the failure to comply was not willful will be considered only if, promptly after the taxpayer becomes aware of the failure, an amended return is filed for the taxable year to which the failure relates that includes the information that should

have been included with the original return for such taxable year or that otherwise complies with the rules of this section, and that includes a written statement explaining the reasons for the failure to comply. The amended return must be filed with the Internal Revenue Service at the location where the taxpayer filed its original return. The taxpayer may submit a request for relief from the penalty under section 6038B as part of the same submission. See §1.6038B–1(f).

(B) *Notice requirement.* In addition to the requirements of paragraph (f)(2)(ii)(A) of this section, the taxpayer must comply with the notice requirements of this paragraph (f)(2)(ii)(B). If any taxable year of the taxpayer is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Internal Revenue Service personnel conducting the examination. If no taxable year of the taxpayer is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Director.

(3) For illustrations of the application of the willfulness standard of this paragraph (f), see the examples in §1.367(a)–8(p)(3).

(4) Paragraph (f) applies to requests for relief submitted on or after November 19, 2014.

[T.D. 9525, 76 FR 26179, May 6, 2011, as amended by T.D. 9704, 79 FR 68766, Nov. 19, 2014]

§1.367(a)–2T Exception for transfers of property for use in the active conduct of a trade or business (temporary).

(a) *In general.* Section 367(a)(1) shall not apply to property transferred to a foreign corporation if—

(1) Such property is transferred for use by that corporation in the active conduct of a trade or business outside of the United States; and

(2) The U.S. person that transfers the property complies with the reporting requirements of section 6038B and regulations thereunder.Where these conditions are satisifed, the foreign corporate transferee of the property shall be considered to be a corporation for purposes of determining the extent to which gain or loss is required to be recognized upon the transfer pursuant to section 332, 351, 354 [reserved as to section 355 or so much of section 356 as relates to section 355], 356, or 361. Paragraph (b) of this section provides rules concerning the requirement that property be transferred for use in the active conduct of a trade or business outside of the United States, while paragraph (c) concerns the application of the requirement where the transferee itself re-transfers the property. In addition, §1.367(a)–3 provides rules concerning the treatment of stock or securities transferred to a foreign corporation in an exchange described in section 367(a)(1), and §1.367(a)–4T provides special rules concerning the treatment of other specified types of property. Finally, §§1.367(a)–5T and 1.367(a)–6T provide rules concerning certain transfers of property that are subject to section 367(a)(1) regardless of whether the property is used in the active conduct of a trade or business.

(b) *Active conduct of a trade or business outside the United States*—(1) *In general.* Property qualifies for the exception provided by this section if it is transferred to a foreign corporation for use in the active conduct of a trade or business outside of the United States. Therefore, to determine whether property is subject to the exception provided by this section, four factual determinations must be made:

(i) What is the trade or business of the transferee;

(ii) Do the activities of the transferee constitute the active conduct of that trade or business;

(iii) Is the trade or business conducted outside of the United States; and

(iv) Is the transferred property used or held for use in the trade or business?

Rules concerning these four determinations are provided in paragraphs (b)(2), (3), (4), and (5) of this section.

(2) *Trade or business.* Whether the activities of a foreign corporation constitute a trade or business must be determined under all the facts and circumstances. In general, a trade or business is a specific unified group of activities that constitute (or could constitute) an independent economic enterprise carried on for profit. For example, the activities of a foreign selling subsidiary could constitute a trade or business if they could be independently carried on for profit, even though the subsidiary acts exclusively on behalf of, and has operations fully integrated with, its parent corporation. To constitute a trade or business, a group of activities must ordinarily include every operation which forms a part of, or a step in, a process by which an enterprise may earn income or profit. In this regard, one or more of such activities may be carried on by independent contractors under the direct control of the foreign corporation. (However, see paragraph (b)(3) of this section.) The group of activities must ordinarily include the collection of income and the payment of expenses. If the activities of a foreign corporation do not constitute a trade or business, then the exception provided by this section does not apply, regardless of the level of activities carried on by the corporation. The following activities are not considered to constitute by themselves a trade or business for purposes of this section:

(i) Any activity giving rise to expenses that would be deductible only under section 212 if the activities were carried on by an individual; or

(ii) The holding for one's own account of investments in stock, securities, land, or other property, including casual sales thereof.

(3) *Active conduct.* Whether a trade or business is actively conducted must be determined under all the facts and circumstances. In general, a corporation actively conducts a trade or business only if the officers and employees of the corporation carry out substantial managerial and operational activities. A corporation may be engaged in the active conduct of a trade or business even though incidental activities of the trade or business are carried out on behalf of the corporation by independent contractors. In determining whether the officers and employees of the corporation carry out substantial managerial and operational activities, however, the activities of independent contractors shall be disregarded. On the other hand, the officers and employees of the corporation are considered to include the officers and employees of related entities who are made available to and supervised on a day-to-day basis by, and whose salaries are paid by (or reimbursed to the lending related entity by), the transferee foreign corporation. Whether a trade or business that produces rents or royalties is actively conducted shall be determined under the principles of §1.954–2(d)(1) (but without regard to whether the rents or royalties are received from an unrelated person). The rule of this paragraph (b)(3) is illustrated by the following example.

Example. X, a domestic corporation, and Y, a foreign corporation not related to X, transfer property to Z, a newly formed foreign corporation organized for the purpose of combining the research activities of X and Y. Z contracts all of its operational and research activities to Y for an arm's-length fee. Z's activities do not constitute the active conduct of a trade or business.

(4) *Outside of the United States.* Whether a foreign corporation conducts a trade or business outside of the United States must be determined under all the facts and circumstances. Generally, the primary managerial and operational activities of the trade or business must be conducted outside the United States and immediately after the transfer the transferred assets must be located outside the United States. Thus, the exception provided by this section would not apply to the transfer of the assets of a domestic business to a foreign corporation if the domestic business continued to operate in the United States after the transfer. In such a case, the primary operational activities of the business would continue to be conducted in the United States. Moreover, the transferred assets would be located in the United States. However, it is not necessary that every item of property transferred be used outside of the United States. As long as the primary managerial and operational activities of the trade or

business are conducted outside of the United States and substantially all of the transferred assets are located outside the United States, incidental items of transferred property located in the United States may be considered to have been transferred for use in the active conduct of a trade or business outside of the United States.

(5) *Use in the trade or business.* Whether property is used or held for use in a trade or business must be determined under all the facts and circumstances. In general, property is used or held for use in a foreign corporation's trade or business if it is—

(i) Held for the principal purpose of promoting the present conduct of the trade or business;

(ii) Acquired and held in the ordinary course of the trade or business; or

(iii) Otherwise held in a direct relationship to the trade or business. Property is considered held in a direct relationship to a trade or business if it is held to meet the present needs of that trade or business and not its anticipated future needs.

Thus, property will not be considered to be held in a direct relationship to a trade or business if it is held for the purpose of providing for future diversification into a new trade or business, future expansion of trade or business activities, future plant replacement, or future business contingencies.

(c) *Property transferred by transferee corporation*—(1) *General rule.* If a foreign corporation receives property in an exchange described in section 367(a)(1) and as part of the same transaction transfers the property to another person, then the exception provided by this section shall not apply to the initial transfer. For purposes of the preceding sentence, a subsequent transfer within six months of the initial transfer shall be considered to be part of the same transaction, and a subsequent transfer more than six months after the initial transfer may be considered to be part of the same transaction upon the application of step-transaction principles.

(2) *Exception.* Notwithstanding paragraph (c)(1) of this section, the active conduct exception provided by this section shall apply to the initial transfer if—

(i) The initial transfer is followed by one or more subsequent transfers described in section 351 or 721; and

(ii) Each subsequent transferee is either a partnership in which the preceding transferor is a general partner or a corporation in which the preceding transferor owns common stock; and

(iii) The ultimate transferee uses the property in the active conduct of a trade or business outside the United States.

(d) *Transitional rule.* Notwithstanding any other provision of this section, property shall be considered to have been transferred for use in the active conduct of a trade or business outside of the United States, if—

(1) The property was transferred after December 31, 1984, and before June 16, 1986;

(2) The property was, or would have been, considered to be transferred for use by the transferee foreign corporation in the active conduct, in any foreign country, or a trade or business, under the principles of section 3.02(1) of Revenue Procedure 68–23, 1968–1 C.B. 821; and

(3) Based on all of the facts and circumstances, it was, or would have been, determined under section 2.02 of Revenue Procedure 68–23 that tax avoidance was not one of the principal purposes of the transaction.

(e) [Reserved] For further guidance see § 1.367(a)–2(e).

[T.D. 8087, 51 FR 17942, May 16, 1986, as amended by T.D. 9406, 73 FR 38115, July 3, 2008; T.D. 9525, 76 FR 26179, May 6, 2011; T.D. 9760, 81 FR 15169, Mar. 22, 2016]

§ 1.367(a)–3 Treatment of transfers of stock or securities to foreign corporations.

(a) *In general*—(1) *Overview.* This section provides rules concerning the transfer of stock or securities by a U.S. person to a foreign corporation in an exchange described in section 367(a)(1). In general, a transfer of stock or securities (including an indirect stock transfer described in paragraph (d) of this section) by a U.S. person to a foreign corporation that is described in section 351, 354 (including a section 354 exchange pursuant to a reorganization described in section 368(a)(1)(B)), 356, or

section 361(a) or (b) is subject to section 367(a)(1). Therefore, gain is recognized on such a transfer unless one of the exceptions set forth in paragraph (a)(2) of this section (regarding general exceptions for certain exchanges of stock or securities), paragraph (b) of this section (regarding transfers of foreign stock or securities), paragraph (c) of this section (regarding transfers of domestic stock or securities), or paragraph (e) of this section (regarding transfers of stock or securities in a section 361 exchange) applies to the transfer. For rules applicable when, pursuant to section 304(a)(1), a U.S. person is treated as transferring stock of a domestic or foreign corporation to a foreign corporation in exchange for stock of such foreign corporation in a transaction to which section 351(a) applies, see §1.367(a)–9T.

(2) *Exceptions for certain exchanges of stock or securities.* Unless otherwise provided, the following exchanges are not subject to section 367(a)(1) and therefore gain is not recognized under section 367(a)(1).

(i) *Section 368(a)(1)(E) reorganizations.* In an exchange under section 354 or 356, a U.S. person exchanges stock or securities of a foreign corporation in a reorganization described in section 368(a)(1)(E).

(ii) *Certain section 368(a)(1) asset reorganizations.* In an exchange under section 354 or 356, a U.S. person exchanges stock or securities of a domestic or foreign corporation pursuant to an asset reorganization that is not treated as an indirect stock transfer under paragraph (d) of this section. See paragraph (d)(3) *Example 16* of this section. For purposes of this section, an *asset reorganization* is defined as a reorganization described in section 368(a)(1) involving a transfer of property under section 361.

(iii) *Certain reorganizations described in sections 368(a)(1)(A) and (a)(2)(E).* If, in an exchange described in section 361, a domestic merging corporation transfers stock of a controlling corporation to a foreign surviving corporation in a reorganization described in section 368(a)(1)(A) and (a)(2)(E), the stock of the controlling corporation transferred in such section 361 exchange is not subject to section 367(a)(1) if the stock of the controlling corporation is provided to the merging corporation by the controlling corporation pursuant to the plan of reorganization. However, a section 361 exchange of other property, including stock of the controlling corporation not provided by the controlling corporation pursuant to the plan of reorganization, by the domestic merging corporation to the foreign surviving corporation pursuant to such a reorganization is described in section 367(a)(1) and therefore subject to section 367(a)(1) unless an exception to section 367(a)(1) applies.

(iv) *Certain triangular reorganizations described in §1.367(b)–10.* If, in an exchange under section 354 or 356, one or more U.S. persons exchange stock or securities of T (as defined in §1.358–6(b)(1)(iii)) in connection with a transaction described in §1.367(b)–10 (applying to certain acquisitions of parent stock or securities for property in triangular reorganizations), section 367(a)(1) shall not apply to such U.S. persons with respect to the exchange of the stock or securities of T if the condition specified in this paragraph (iv) is satisfied. The condition specified in this paragraph (iv) is that the amount of gain in the T stock or securities that would otherwise be recognized under section 367(a)(1) (without regard to any exceptions thereto) pursuant to the indirect stock transfer rules of paragraph (d) of this section is less than the sum of the amount of the deemed distribution under §1.367(b)–10 treated as a dividend under section 301(c)(1) and the amount of such deemed distribution treated as gain from the sale or exchange of property under section 301(c)(3). See §1.367(b)–10(a)(2)(iii) (providing a similar rule that excludes certain transactions from the application of §1.367(b)–10).

(3) *Cross-references.* For rules regarding other indirect or constructive transfers of stock or securities subject to section 367(a)(1) (unless an exception applies) see §1.367(a)–1T(c). For additional rules regarding a transfer of stock or securities in an exchange described in section 361(a) or (b), see §1.367(a)–7. For special basis and holding period rules involving foreign corporations that are parties to certain

triangular reorganizations under section 368(a)(1), see §1.367(b)–13. For additional rules relating to certain nonrecognition exchanges involving a foreign corporation, see section 367(b) and the regulations under that section. For rules regarding reporting requirements with respect to transfers described under section 367(a), see section 6038B and the regulations thereunder. For rules related to expatriated entities, see section 7874 and the regulations thereunder.

(b) *Transfers of stock or securities of foreign corporations* —(1) *General rule.* Except as provided in paragraph (e) of this section, a transfer of stock or securities of a foreign corporation by a U.S. person to a foreign corporation that would otherwise be subject to section 367(a)(1) under paragraph (a) of this section will not be subject to section 367(a)(1) if either—

(i) *Less than 5-percent shareholder.* The U.S. person owns less than five percent (applying the attribution rules of section 318, as modified by section 958(b)) of both the total voting power and the total value of the stock of the transferee foreign corporation immediately after the transfer; or

(ii) *5-percent shareholder.* The U.S. person enters into a five-year gain recognition agreement with respect to the transferred stock or securities as provided in §1.367(a)–8.

(2) *Certain transfers subject to sections 367(a) and (b)*—(i) *In general.* A transfer of stock or securities described in section 367(a) or the regulations thereunder as well as in section 367(b) or the regulations thereunder shall be subject concurrently to sections 367(a) and (b) and the respective regulations thereunder, except as provided in paragraph (b)(2)(i)(A) through (C) of this section. See paragraph (d)(3) *Examples 11* and *14* of this section.

(A) Section 367(b) and the regulations thereunder shall not apply if a foreign corporation is not treated as a corporation under section 367(a)(1). See the example in paragraph (b)(2)(ii) of this section and paragraph (d)(3) *Example 14* of this section.

(B) If a foreign corporation transfers assets to a domestic corporation in a transaction to which §1.367(b)–3(a) and (b) and the indirect stock transfer rules of paragraph (d) of this section apply, and all the earnings and profits amount attributable to the stock of an exchanging shareholder under §1.367(b)–3(b) is greater than the amount of gain in such stock subject to section 367(a) pursuant to the indirect stock transfer rules of paragraph (d) of this section, then the rules of section 367(b), and not the rules of section 367(a), shall apply to the exchange. See paragraph (d)(3) *Example 15* of this section.

(C) [Reserved] For further guidance, see §1.367(a)–3T(b)(2)(i)(C).

(ii) *Example.* The following example illustrates the provisions of this paragraph (b)(2):

Example. (i) *Facts.* DC, a domestic corporation, owns all of the stock of FC1, a controlled foreign corporation within the meaning of section 957(a). DC's basis in the stock of FC1 is $50, and the value of such stock is $100. The section 1248 amount with respect to such stock is $30. FC2, also a foreign corporation, is owned entirely by foreign individuals who are not related to DC or FC1. In a reorganization described in section 368(a)(1)(B), FC2 acquires all of the stock of FC1 from DC in exchange for 20 percent of the voting stock of FC2. FC2 is not a controlled foreign corporation after the reorganization.

(ii) *Result without gain recognition agreement.* Under the provisions of this paragraph (b), if DC fails to enter into a gain recognition agreement, DC is required to recognize in the year of the transfer the $50 of gain that it realized upon the transfer, $30 of which will be treated as a dividend under section 1248.

(iii) *Result with gain recognition agreement.* If DC enters into a gain recognition agreement under §1.367(a)–8 with respect to the transfer of FC1 stock, the exchange will also be subject to the provisions of section 367(b) and the regulations thereunder to the extent that it is not subject to tax under section 367(a)(1). In such case, DC will be required to recognize the section 1248 amount of $30 on the exchange of FC1 for FC2 stock. See §1.367(b)–4(b). The deemed dividend of $30 recognized by DC will increase its basis in the FC1 stock exchanged in the transaction and, therefore, the basis of the FC2 stock received in the transaction. The remaining gain of $20 realized by DC (otherwise recognizable under section 367(a)) in the exchange of FC1 stock will not be recognized if DC enters into a gain recognition agreement with respect to the transfer. (The result would be unchanged if, for example, the exchange of FC1 stock for FC2 stock qualified as a section 351 exchange, or as an exchange

described in both sections 351 and 368(a)(1)(B).)

(c) *Transfers of stock or securities of domestic corporations*—(1) *General rule.* Except as provided in paragraph (e) of this section, a transfer of stock or securities of a domestic corporation by a U.S. person to a foreign corporation that would otherwise be subject to section 367(a)(1) under paragraph (a) of this section will not be subject to section 367(a)(1) if the domestic corporation the stock or securities of which are transferred (referred to as the U.S. target company) complies with the reporting requirements in paragraph (c)(6) of this section and if each of the following four conditions is met:

(i) Fifty percent or less of both the total voting power and the total value of the stock of the transferee foreign corporation is received in the transaction, in the aggregate, by U.S. transferors (*i.e.*, the amount of stock received does not exceed the 50-percent ownership threshold).

(ii) Fifty percent or less of each of the total voting power and the total value of the stock of the transferee foreign corporation is owned, in the aggregate, immediately after the transfer by U.S. persons that are either officers or directors of the U.S. target company or that are five-percent target shareholders (as defined in paragraph (c)(5)(iii) of this section) (*i.e.*, there is no control group). For purposes of this paragraph (c)(1)(ii), any stock of the transferee foreign corporation owned by U.S. persons immediately after the transfer will be taken into account, whether or not it was received in the exchange for stock or securities of the U.S. target company.

(iii) Either—

(A) The U.S. person is not a five-percent transferee shareholder (as defined in paragraph (c)(5)(ii) of this section); or

(B) The U.S. person is a five-percent transferee shareholder and enters into a five-year agreement to recognize gain with respect to the U.S. target company stock or securities it exchanged in the form provided in §1.367(a)–8; and

(iv) The active trade or business test (as defined in paragraph (c)(3) of this section) is satisfied.

(2) *Ownership presumption.* For purposes of paragraph (c)(1) of this section, persons who transfer stock or securities of the U.S. target company in exchange for stock of the transferee foreign corporation are presumed to be U.S. persons. This presumption may be rebutted in accordance with paragraph (c)(7) of this section.

(3) *Active trade or business test*—(i) *In general.* The tests of this paragraph (c)(3), collectively referred to as the active trade or business test, are satisfied if:

(A) The transferee foreign corporation or any qualified subsidiary (as defined in paragraph (c)(5)(vii) of this section) or any qualified partnership (as defined in paragraph (c)(5)(viii) of this section) is engaged in an active trade or business outside the United States, within the meaning of §1.367(a)–2T(b)(2) and (3), for the entire 36-month period immediately before the transfer;

(B) At the time of the transfer, neither the transferors nor the transferee foreign corporation (and, if applicable, the qualified subsidiary or qualified partnership engaged in the active trade or business) have an intention to substantially dispose of or discontinue such trade or business; and

(C) The substantiality test (as defined in paragraph (c)(3)(iii) of this section) is satisfied.

(ii) *Special rules.* For purposes of paragraphs (c)(3)(i)(A) and (B) of this section, the following special rules apply:

(A) The transferee foreign corporation, a qualified subsidiary, or a qualified partnership will be considered to be engaged in an active trade or business for the entire 36-month period preceding the exchange if it acquires at the time of, or any time prior to, the exchange a trade or business that has been active throughout the entire 36-month period preceding the exchange. This special rule shall not apply, however, if the acquired active trade or business assets were owned by the U.S. target company or any affiliate (within the meaning of section 1504(a) but excluding the exceptions contained in section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein) at any time during the

36-month period prior to the acquisition. Nor will this special rule apply if the principal purpose of such acquisition is to satisfy the active trade or business test.

(B) An active trade or business does not include the making or managing of investments for the account of the transferee foreign corporation or any affiliate (within the meaning of section 1504(a) but excluding the exceptions contained in section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein). (This paragraph (c)(3)(ii)(B) shall not create any inference as to the scope of §1.367(a)–2T(b)(2) and (3) for other purposes.)

(iii) *Substantiality test*—(A) *General rule.* A transferee foreign corporation will be deemed to satisfy the substantiality test if, at the time of the transfer, the fair market value of the transferee foreign corporation is at least equal to the fair market value of the U.S. target company.

(B) *Special rules.* (*1*) For purposes of paragraph (c)(3)(iii)(A) of this section, the value of the transferee foreign corporation shall include assets acquired outside the ordinary course of business by the transferee foreign corporation within the 36-month period preceding the exchange only if either—

(*i*) Both—

(*A*) At the time of the exchange, such assets or, as applicable, the proceeds thereof, do not produce, and are not held for the production of, passive income as defined in section 1297(b); and

(*B*) Such assets are not acquired for the principal purpose of satisfying the substantiality test; or

(*ii*) Such assets consist of the stock of a qualified subsidiary or an interest in a qualified partnership. See paragraph (c)(3)(iii)(B)(*2*) of this section.

(*2*) For purposes of paragraph (c)(3)(iii)(A) of this section, the value of the transferee foreign corporation shall not include the value of the stock of any qualified subsidiary or the value of any interest in a qualified partnership, held directly or indirectly, to the extent that such value is attributable to assets acquired by such qualified subsidiary or partnership outside the ordinary course of business and within the 36-month period preceding the exchange unless those assets satisfy the requirements in paragraph (c)(3)(iii)(B)(*1*) of this section.

(*3*) For purposes of paragraph (c)(3)(iii)(A) of this section, the value of the transferee foreign corporation shall not include the value of assets received within the 36-month period prior to the acquisition, notwithstanding the special rule in paragraph (c)(3)(iii)(B)(*1*) of this section, if such assets were owned by the U.S. target company or an affiliate (within the meaning of section 1504(a) but without the exceptions under section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein) at any time during the 36-month period prior to the transaction.

(4) *Special rules*—(i) *Treatment of partnerships.* For purposes of this paragraph (c), if a partnership (whether domestic or foreign) owns stock or securities in the U.S. target company or the transferee foreign corporation, or transfers stock or securities in an exchange described in section 367(a), each partner in the partnership, and not the partnership itself, is treated as owning and as having transferred, or as owning, a proportionate share of the stock or securities. See §1.367(a)–1T(c)(3).

(ii) *Treatment of options.* For purposes of this paragraph (c), one or more options (or an interest similar to an option) will be treated as exercised and thus will be counted as stock for purposes of determining whether the 50-percent threshold is exceeded or whether a control group exists if a principal purpose of the issuance or the acquisition of the option (or other interest) was the avoidance of the general rule contained in section 367(a)(1).

(iii) *U.S. target has a vestigial ownership interest in transferee foreign corporation.* In cases where, immediately after the transfer, the U.S. target company owns, directly or indirectly (applying the attribution rules of sections 267(c)(1) and (5)), stock of the transferee foreign corporation, that stock will not in any way be taken into account (and, thus, will not be treated as outstanding) in determining whether the 50-percent threshold under paragraph (c)(1)(i) of this section is exceeded or whether a control group under paragraph (c)(1)(ii) of this section exists.

(iv) *Attribution rule.* Except as otherwise provided in this section, the rules of section 318, as modified by the rules of section 958(b) shall apply for purposes of determining the ownership or receipt of stock, securities or other property under this paragraph (c).

(5) *Definitions*—(i) *Ownership statement.* An ownership statement is a statement, signed under penalties of perjury, stating—

(A) The identity and taxpayer identification number, if any, of the person making the statement;

(B) That the person making the statement is not a U.S. person (as defined in paragraph (c)(5)(iv) of this section);

(C) That the person making the statement either—

(*1*) Owns less than 1 percent of the total voting power and total value of a U.S. target company the stock of which is described in Rule 13d–1(d) of Regulation 13D (17 CFR 240.13d–1(d)) (or any rule or regulation to generally the same effect) promulgated by the Securities and Exchange Commission under the Securities and Exchange Act of 1934 (15 U.S.C. 78m), and such person did not acquire the stock with a principal purpose to enable the U.S. transferors to satisfy the requirement contained in paragraph (c)(1)(i) of this section; or

(*2*) Is not related to any U.S. person to whom the stock or securities owned by the person making the statement are attributable under the rules of section 958(b), and did not acquire the stock with a principal purpose to enable the U.S. transferors to satisfy the requirement contained in paragraph (c)(1)(i) of this section;

(D) The citizenship, permanent residence, home address, and U.S. address, if any, of the person making the statement; and

(E) The ownership such person has (by voting power and by value) in the U.S. target company prior to the exchange and the amount of stock of the transferee foreign corporation (by voting power and value) received by such person in the exchange.

(ii) *Five-percent transferee shareholder.* A five-percent transferee shareholder is a person that owns at least five percent of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer described in section 367(a)(1). For special rules involving cases in which stock is held by a partnership, see paragraph (c)(4)(i) of this section.

(iii) *Five-percent target shareholder and certain other 5-percent shareholders.* A five-percent target shareholder is a person that owns at least five percent of either the total voting power or the total value of the stock of the U.S. target company immediately prior to the transfer described in section 367(a)(1). If the stock of the U.S. target company (or any company through which stock of the U.S. target company is owned indirectly or constructively) is described in Rule 13d–1(d) of Regulation 13D (17 CFR 240.13d–1(d)) (or any rule or regulation to generally the same effect), promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78m), then, in the absence of actual knowledge to the contrary, the existence or absence of filings of Schedule 13–D or 13–G (or any similar schedules) may be relied upon for purposes of identifying five-percent target shareholders (or a five-percent shareholder of a corporation which itself is a five-percent shareholder of the U.S. target company). For special rules involving cases in which U.S. target company stock is held by a partnership, see paragraph (c)(4)(i) of this section.

(iv) *U.S. Person.* For purposes of this section, a U.S. person is defined by reference to §1.367(a)–1T(d)(1). For application of the rules of this section to stock or securities owned or transferred by a partnership that is a U.S. person, however, see paragraph (c)(4)(i) of this section.

(v) *U.S. Transferor.* A U.S. transferor is a U.S. person (as defined in paragraph (c)(5)(iv) of this section) that transfers stock or securities of one or more U.S. target companies in exchange for stock of the transferee foreign corporation in an exchange described in section 367.

(vi) *Transferee foreign corporation.* Except as provided in paragraph (d)(2)(i)(B) of this section, a transferee foreign corporation is the foreign corporation whose stock is received in the exchange by U.S. persons.

(vii) *Qualified Subsidiary*. A qualified subsidiary is a foreign corporation whose stock is at least 80-percent owned (by total voting power and total value), directly or indirectly, by the transferee foreign corporation. However, a corporation will not be treated as a qualified subsidiary if it was affiliated with the U.S. target company (within the meaning of section 1504(a) but without the exceptions under section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein) at any time during the 36-month period prior to the transfer. Nor will a corporation be treated as a qualified subsidiary if it was acquired by the transferee foreign corporation at any time during the 36-month period prior to the transfer for the principal purpose of satisfying the active trade or business test, including the substantiality test.

(viii) *Qualified partnership*. (A) Except as provided in paragraph (c)(5)(viii)(B) or (C) of this section, a qualified partnership is a partnership in which the transferee foreign corporation—

(*1*) Has active and substantial management functions as a partner with regard to the partnership business; or

(*2*) Has an interest representing a 25 percent or greater interest in the partnership's capital and profits.

(B) A partnership is not a qualified partnership if the U.S. target company or any affiliate of the U.S. target company (within the meaning of section 1504(a) but without the exceptions under section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein) held a 5 percent or greater interest in the partnership's capital and profits at any time during the 36-month period prior to the transfer.

(C) A partnership is not a qualified partnership if the transferee foreign corporation's interest was acquired by that corporation at any time during the 36-month period prior to the transfer for the principal purpose of satisfying the active trade or business test, including the substantiality test.

(6) *Reporting requirements of U.S. target company*. (i) In order for a U.S. person that transfers stock or securities of a domestic corporation to qualify for the exception provided by this paragraph (c) to the general rule under section 367(a)(1), in cases where 10 percent or more of the total voting power or the total value of the stock of the U.S. target company is transferred by U.S. persons in the transaction, the U.S. target company must comply with the reporting requirements contained in this paragraph (c)(6). The U.S. target company must attach to its timely filed U.S. income tax return for the taxable year in which the transfer occurs a statement titled ''Section 367(a)—Reporting of Cross-Border Transfer Under Reg. §1.367(a)–3(c)(6),'' signed under penalties of perjury by an officer of the corporation to the best of the officer's knowledge and belief, disclosing the following information—

(A) A description of the transaction in which a U.S. person or persons transferred stock or securities in the U.S. target company to the transferee foreign corporation in a transfer otherwise subject to section 367(a)(1);

(B) The amount (specified as to the percentage of the total voting power and the total value) of stock of the transferee foreign corporation received in the transaction, in the aggregate, by persons who transferred stock or securities of the U.S. target company. For additional information that may be required to rebut the ownership presumption of paragraph (c)(2) of this section in cases where more than 50 percent of either the total voting power or the total value of the stock of the transferee foreign corporation is received in the transaction, in the aggregate, by persons who transferred stock or securities of the U.S. target company, see paragraph (c)(7) of this section;

(C) The amount (if any) of transferee foreign corporation stock owned directly or indirectly (applying the attribution rules of sections 267(c)(1) and (5)) immediately after the exchange by the U.S. target company;

(D) A statement that there is no control group within the meaning of paragraph (c)(1)(ii) of this section;

(E) A list of U.S. persons who are officers, directors or five-percent target shareholders and the percentage of the total voting power and the total value of the stock of the transferee foreign corporation owned by such persons

both immediately before and immediately after the transaction; and

(F) A statement that includes the following—

(*1*) A statement that the active trade or business test described in paragraph (c)(3) of this section is satisfied by the transferee foreign corporation and a description of such business;

(*2*) A statement that on the day of the transaction, there was no intent on the part of the transferee foreign corporation (or its qualified subsidiary, if relevant) or the transferors of the transferee foreign corporation (or qualified subsidiary, if relevant) to substantially discontinue its active trade or business; and

(*3*) A statement that the substantiality test described in paragraph (c)(3)(iii) of this section is satisfied, and documentation that such test is satisfied, including the value of the transferee foreign corporation and the value of the U.S. target company on the day of the transfer, and either one of the following—

(*i*) A statement demonstrating that the value of the transferee foreign corporation 36 months prior to the acquisition, plus the value of any assets described in paragraph (c)(3)(iii)(B) of this section (including stock) acquired by the transferee foreign corporation within the 36-month period, less the amount of any liabilities acquired during that period, equals or exceeds the value of the U.S. target company on the acquisition date; or

(*ii*) A statement demonstrating that the value of the transferee foreign corporation on the date of the acquisition, reduced by the value of any assets not described in paragraph (c)(3)(iii)(B) of this section (including stock) acquired by the transferee foreign corporation within the 36-month period, equals or exceeds the value of the U.S. target company on the date of the acquisition.

(ii) Except as provided in paragraph (f) of this section, for purposes of this paragraph (c)(6), a U.S. income tax return will be considered timely filed if it is filed on or before the last date prescribed for filing (taking into account any extensions of time therefor) for the taxable year in which the transfer occurs.

(7) *Ownership statements.* To rebut the ownership presumption of paragraph (c)(2) of this section, the U.S. target company must obtain ownership statements (described in paragraph (c)(5)(i) of this section) from a sufficient number of persons that transfer U.S. target company stock or securities in the transaction that are not U.S. persons to demonstrate that the 50-percent threshold of paragraph (c)(1)(i) of this section is not exceeded. In addition, the U.S. target company must attach to its timely filed U.S. income tax return (as described in paragraph (c)(6)(ii) of this section) for the taxable year in which the transfer occurs a statement, titled ''Section 367(a)—Compilation of Ownership Statements Under Reg. §1.367(a)–3(c),'' signed under penalties of perjury by an officer of the corporation, disclosing the following information:

(i) The amount (specified as to the percentage of the total voting power and the total value) of stock of the transferee foreign corporation received, in the aggregate, by U.S. transferors;

(ii) The amount (specified as to the percentage of total voting power and total value) of stock of the transferee foreign corporation received, in the aggregate, by foreign persons that filed ownership statements;

(iii) A summary of the information tabulated from the ownership statements, including—

(A) The names of the persons that filed ownership statements stating that they are not U.S. persons;

(B) The countries of residence and citizenship of such persons; and

(C) Each of such person's ownership (by voting power and by value) in the U.S. target company prior to the exchange and the amount of stock of the transferee foreign corporation (by voting power and value) received by such persons in the exchange.

(8) *Certain transfers in connection with performance of services.* Section 367(a)(1) shall not apply to a domestic corporation's transfer of its own stock or securities in connection with the performance of services, if the transfer is considered to be to a foreign corporation solely by reason of §1.83–6(d)(1). The

transfer may still, however, be reportable under section 6038B. See §1.6038B–1(b)(2)(i)(A)(*4*) and (b)(2)(i)(B)(*4*).

(9) *Private letter ruling option.* The Internal Revenue Service may, in limited circumstances, issue a private letter ruling to permit the taxpayer to qualify for an exception to the general rule under section 367(a)(1) if—

(i) A taxpayer is unable to satisfy all of the requirements of paragraph (c)(3) of this section relating to the active trade or business test of paragraph (c)(1)(iv) of this section, but such taxpayer meets all of the other requirements contained in paragraphs (c)(1)(i) through (c)(1)(iii) of this section, and such taxpayer is substantially in compliance with the rules set forth in paragraph (c)(3) of this section; or

(ii) A taxpayer is unable to satisfy any requirement of paragraph (c)(1) of this section due to the application of paragraph (c)(4)(iv) of this section. Notwithstanding the preceding sentence, in no event will the Internal Revenue Service rule on the issue of whether the principal purpose of an acquisition was to satisfy the active trade or business test, including the substantiality test.

(10) *Examples.* This paragraph (c) may be illustrated by the following examples:

Example 1. Ownership presumption. (i) FC, a foreign corporation, issues 51 percent of its stock to the shareholders of S, a domestic corporation, in exchange for their S stock, in a transaction described in section 367(a)(1).

(ii) Under paragraph (c)(2) of this section, all shareholders of S who receive stock of FC in the exchange are presumed to be U.S. persons. Unless this ownership presumption is rebutted, the condition set forth in paragraph (c)(1)(i) of this section will not be satisfied, and the exception in paragraph (c)(1) of this section will not be available. As a result, all U.S. persons that transferred S stock will recognize gain on the exchange. To rebut the ownership presumption, S must comply with the reporting requirements contained in paragraph (c)(6) of this section, obtaining ownership statements (described in paragraph (c)(5)(i) of this section) from a sufficient number of non-U.S. persons who received FC stock in the exchange to demonstrate that the amount of FC stock received by U.S. persons in the exchange does not exceed 50 percent.

Example 2. Filing of Gain Recognition Agreement. (i) The facts are the same as in *Example 1,* except that FC issues only 40 percent of its stock to the shareholders of S in the exchange. FC satisfies the active trade or business test of paragraph (c)(1)(iv) of this section. A, a U.S. person, owns 10 percent of S's stock immediately before the transfer. All other shareholders of S own less than five percent of its stock. None of S's officers or directors owns any stock in FC immediately after the transfer. A will own 15 percent of the stock of FC immediately after the transfer, 4 percent received in the exchange, and the balance being stock in FC that A owned prior to and independent of the transaction. No S shareholder besides A owns five percent or more of FC immediately after the transfer. The reporting requirements under paragraph (c)(6) of this section are satisfied.

(ii) The condition set forth in paragraph (c)(1)(i) of this section is satisfied because, even after application of the presumption in paragraph (c)(2) of this section, U.S. transferors could not receive more than 50 percent of FC's stock in the transaction. There is no control group because five-percent target shareholders and officers and directors of S do not, in the aggregate, own more than 50 percent of the stock of FC immediately after the transfer (A, the sole five-percent target shareholder, owns 15 percent of the stock of FC immediately after the transfer, and no officers or directors of S own any stock of FC immediately after the transfer). Therefore, the condition set forth in paragraph (c)(1)(ii) of this section is satisfied. The facts assume that the condition set forth in paragraph (c)(1)(iv) of this section is satisfied. Thus, U.S. persons that are not five-percent transferee shareholders will not recognize gain on the exchange of S shares for FC shares. A, a five-percent transferee shareholder, will not be required to include in income any gain realized on the exchange in the year of the transfer if he files a 5-year gain recognition agreement (GRA) and complies with section 6038B.

Example 3. Control Group. (i) The facts are the same as in *Example 2,* except that B, another U.S. person, is a 5-percent target shareholder, owning 25 percent of S's stock immediately before the transfer. B owns 40 percent of the stock of FC immediately after the transfer, 10 percent received in the exchange, and the balance being stock in FC that B owned prior to and independent of the transaction.

(ii) A control group exists because A and B, each a five-percent target shareholder within the meaning of paragraph (c)(5)(iii) of this section, together own more than 50 percent of FC immediately after the transfer (counting both stock received in the exchange and stock owned prior to and independent of the exchange). As a result, the condition set forth in paragraph (c)(1)(ii) of this section is not satisfied, and all U.S. persons (not merely A and B) who transferred S stock will recognize gain on the exchange.

Example 4. Partnerships. (i) The facts are the same as in *Example 3,* except that B is a partnership (domestic or foreign) that has five equal partners, only two of whom, X and Y, are U.S. persons. Under paragraph (c)(4)(i) of this section, X and Y are treated as the owners and transferors of 5 percent each of the S stock owned and transferred by B and as owners of 8 percent each of the FC stock owned by B immediately after the transfer. U.S. persons that are five-percent target shareholders thus own a total of 31 percent of the stock of FC immediately after the transfer (A's 15 percent, plus X's 8 percent, plus Y's 8 percent).

(ii) Because no control group exists, the condition in paragraph (c)(1)(ii) of this section is satisfied. The conditions in paragraphs (c)(1)(i) and (iv) of this section also are satisfied. Thus, U.S. persons that are not five-percent transferee shareholders will not recognize gain on the exchange of S shares for FC shares. A, X, and Y, each a five-percent transferee shareholder, will not be required to include in income in the year of the transfer any gain realized on the exchange if they file 5-year GRAs and comply with section 6038B.

(11) *Effective date.* This paragraph (c) applies to transfers occurring after January 29, 1997. However, taxpayers may elect to apply this section in its entirety to all transfers occurring after April 17, 1994, provided that the statute of limitations of the affected tax year or years is open.

(d) *Indirect stock transfers in certain nonrecognition transfers*—(1) *In general.* For purposes of this section, a U.S. person who exchanges, under section 354 (or section 356) stock or securities in a domestic or foreign corporation for stock or securities in a foreign corporation (or in a domestic corporation in control of a foreign acquiring corporation in a triangular section 368(a)(1)(B) reorganization) in connection with a transaction described in paragraphs (d)(1)(i) through (v) of this section (or who is deemed to make such an exchange under paragraph (d)(1)(vi) of this section) shall, except as provided in paragraph (d)(2)(vii) of this section, be treated as having made an indirect transfer of such stock or securities to a foreign corporation that is subject to the rules of this section, including, for example, the requirement, where applicable, that the U.S. transferor enter into a gain recognition agreement to preserve nonrecognition treatment under section 367(a). If the U.S. person exchanges stock or securities of a foreign corporation, see also section 367(b) and the regulations thereunder. For examples of the concurrent application of the indirect stock transfer rules under section 367(a) and the rules of section 367(b), see paragraph (d)(3) *Examples 14* and *15* of this section. For purposes of this paragraph (d), if a corporation acquiring assets in an asset reorganization transfers all or a portion of such assets to a corporation controlled (within the meaning of section 368(c)) by the acquiring corporation as part of the same transaction, the subsequent transfer of assets to the controlled corporation will be referred to as a controlled asset transfer. See section 368(a)(2)(C).

(i) *Mergers described in sections 368(a)(1)(A) and (a)(2)(D) and reorganizations described in sections 368(a)(1)(G) and (a)(2)(D).* A U.S. person exchanges stock or securities of a corporation (the acquired corporation) for stock or securities of a foreign corporation that controls the acquiring corporation in a reorganization described in either sections 368(a)(1)(A) and (a)(2)(D), or in sections 368(a)(1)(G) and (a)(2)(D). See paragraph (d)(3) *Example 1* of this section for an example of a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) involving domestic acquired and acquiring corporations, and see paragraph (d)(3) *Example 10* of this section for an example involving a domestic acquired corporation and a foreign acquiring corporation.

(ii) *Mergers described in sections 368(a)(1)(A) and (a)(2)(E).* A U.S. person exchanges stock or securities of a corporation (the acquiring corporation) for stock or securities in a foreign corporation that controls the acquired corporation in a reorganization described in sections 368(a)(1)(A) and (a)(2)(E). See paragraph (d)(3) *Example 2* of this section for an example of a reorganization described in sections 368(a)(1)(A) and (a)(2)(E) involving domestic acquired and acquiring corporations, and see paragraph (d)(3) *Example 11* of this section for an example involving a domestic acquired corporation and a foreign acquiring corporation.

(iii) *Triangular reorganizations described in section 368(a)(1)(B)*—(A) A U.S.

person exchanges stock or securities of the acquired corporation for voting stock or securities of a foreign corporation that is in control (as defined in section 368(c)) of the acquiring corporation in a reorganization described in section 368(a)(1)(B). See paragraph (d)(3) *Example 5* of this section.

(B) A U.S. person exchanges stock or securities of the acquired corporation for voting stock or securities of a domestic corporation that is in control (as defined in section 368(c)) of a foreign acquiring corporation in a reorganization described in section 368(a)(1)(B). See paragraph (d)(3) *Example 5A* of this section.

(iv) *Triangular reorganizations described in section 368(a)(1)(C).* A U.S. person exchanges stock or securities of a corporation (the acquired corporation) for voting stock or securities of a foreign corporation that controls the acquiring corporation in a reorganization described in section 368(a)(1)(C). See, e.g., paragraph (d)(3) *Example 6* of this section (for an example of a triangular section 368(a)(1)(C) reorganization involving domestic acquired and acquiring corporations), and paragraph (d)(3) *Example 8* of this section (for an example involving a domestic acquired corporation and a foreign acquiring corporation). If the acquired corporation is a foreign corporation, see paragraph (d)(3) *Example 14* of this section, and section 367(b) and the regulations thereunder.

(v) *Transfers of assets to subsidiaries in certain section 368(a)(1) reorganizations.* A U.S. person exchanges stock or securities of a corporation (the acquired corporation) for stock or securities of a foreign acquiring corporation in an asset reorganization (other than a triangular section 368(a)(1)(C) reorganization described in paragraph (d)(1)(iv) of this section, a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) or sections 368(a)(1)(G) and (a)(2)(D) described in paragraph (d)(1)(i) of this section, a reorganization described in sections 368(a)(1)(A) and (a)(2)(E) described in paragraph (d)(1)(ii) of this section, or a same-country section 368(a)(1)(F) reorganization) that is followed by a controlled asset transfer. For purposes of this section, a same-country section 368(a)(1)(F) reorganization is a reorganization described in section 368(a)(1)(F) in which both the acquired corporation and the acquiring corporation are foreign corporations and are created or organized under the laws of the same foreign country. In the case of a transaction described in this paragraph (d)(1)(v) in which some but not all of the assets of the acquired corporation are transferred in a controlled asset transfer, the transaction shall be considered to be an indirect transfer of stock or securities subject to this paragraph (d) only to the extent of the assets so transferred. The remaining assets shall be treated as having been transferred by the acquired corporation in an asset transfer rather than an indirect stock transfer, and, if the acquired corporation is a domestic corporation, such asset transfer shall be subject to the other provisions of section 367, including sections 367(a)(1), (3), and (5), and (d). See paragraph (d)(3) *Examples 6A* and *6B* of this section.

(vi) *Successive transfers of property to which section 351 applies.* A U.S. person transfers property (other than stock or securities) to a foreign corporation in an exchange described in section 351, and all or a portion of such assets transferred to the foreign corporation by such person are, in connection with the same transaction, transferred to a second corporation that is controlled by the foreign corporation in one or more exchanges described in section 351. For purposes of this paragraph (d)(1) and §1.367(a)–8, the initial transfer by the U.S. person shall be deemed to be a transfer of stock described in section 354. (Any assets transferred to the foreign corporation that are not transferred by the foreign corporation to a second corporation shall be treated as a transfer of assets subject to the general rules of section 367, including sections 367(a)(1), (3), (5) and (d), and not as an indirect stock transfer under the rules of this paragraph (d).) See, e.g., paragraph (d)(3) *Example 13* and *Example 13A* of this section.

(2) *Special rules for indirect transfers.* If a U.S. person is considered to make an indirect transfer of stock or securities described in paragraph (d)(1) of this section, the rules of this section and §1.367(a)–8 shall apply to the transfer.

For purposes of applying the rules of this section and §1.367(a)–8:

(i) *Transferee foreign corporation*—(A) *General rule.* Except as provided in paragraph (d)(2)(i)(B) of this section, the transferee foreign corporation shall be the foreign corporation that issues stock or securities to the U.S. person in the exchange.

(B) *Special rule for triangular reorganizations described in paragraph (d)(1)(iii)(B) of this section.* In the case of a triangular reorganization described in paragraph (d)(1)(iii)(B) of this section, the transferee foreign corporation shall be the foreign acquiring corporation. See paragraph (d)(3) *Example 5A* of this section.

(ii) *Transferred corporation.* The transferred corporation shall be the acquiring corporation, except as provided in this paragraph (d)(2)(ii). In the case of a triangular section 368(a)(1)(B) reorganization described in paragraph (d)(1)(iii) of this section, the transferred corporation shall be the acquired corporation. In the case of an indirect stock transfer described in paragraph (d)(1)(i), (ii), or (iv) of this section followed by a controlled asset transfer, or an indirect stock transfer described in paragraph (d)(1)(v) of this section, the transferred corporation shall be the controlled corporation to which the assets are transferred. In the case of successive section 351 transfers described in paragraph (d)(1)(vi) of this section, the transferred corporation shall be the corporation to which the assets are transferred in the final section 351 transfer. The transferred property shall be the stock or securities of the transferred corporation, as appropriate under the circumstances.

(iii) *Amount of gain.* For purposes of determining the amount of gain that a U.S. person is required to include in income as a result of a triggering event, see §1.367(a)–8(c)(1)(i).

(iv) *Gain recognition agreements involving multiple parties.* The U.S. person's agreement to recognize gain, as provided in §1.367(a)–8, shall include appropriate provisions consistent with the principles of §1.367(a)–8. See *Examples 5* and *5A* of this section and §1.367(a)–8(j)(9).

(v) *Determination of whether substantially all of the transferred corporation's assets are disposed of.* For purposes of applying §1.367(a)–8(j)(2)(i) to determine whether substantially all of the assets of the transferred corporation have been disposed of, the following assets shall be taken into account (but only if such assets are not fully taxable under section 367 in the taxable year that includes the indirect transfer)—

(A) In the case of a reorganization described in paragraph (d)(1)(i) of this section (a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) or sections 368(a)(1)(G) and (a)(2)(D)) or a reorganization described in section (d)(1)(iv) of this section (a triangular section 368(a)(1)(C) reorganization), the assets of the acquired corporation;

(B) In the case of a sections 368(a)(1)(A) and (a)(2)(E) reorganization described in paragraph (d)(1)(ii) of this section, the assets of the acquiring corporation immediately prior to the transaction;

(C) In the case of an asset reorganization followed by a controlled asset transfer, as described in paragraph (d)(1)(v) of this section, the assets of the acquired corporation that are transferred to the corporation controlled by the acquiring corporation;

(D) In the case of a triangular reorganization described in section 368(a)(1)(C) followed by a controlled asset transfer, a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) followed by a controlled asset transfer, or a reorganization described in sections 368(a)(1)(G) and (a)(2)(D) followed by a controlled asset transfer, the assets of the acquired corporation including those transferred to the corporation controlled by the acquiring corporation;

(E) In the case of a reorganization described in sections 368(a)(1)(A) and (a)(2)(E) followed by a controlled asset transfer, the assets of the acquiring corporation including those transferred to the corporation controlled by the acquiring corporation; and

(F) In the case of successive section 351 exchanges described in paragraph (d)(1)(vi) of this section, the assets that are both transferred initially to the foreign corporation, and transferred by the foreign corporation to a second corporation.

(vi) *Coordination between asset transfer rules and indirect stock transfer rules*—(A) *General rule.* Except as otherwise provided in this paragraph (d)(2)(vi), if, pursuant to any of the transactions described in paragraph (d)(1) of this section, a U.S. person transfers (or is deemed to transfer) assets to a foreign corporation in an exchange described in section 351 or section 361, the rules of section 367, including sections 367(a)(1), (a)(3), and (a)(5), as well as section 367(d), and the regulations thereunder shall apply prior to the application of the rules of this section.

(B) *Exceptions*—(*1*) If a transaction is described in paragraph (d)(2)(vi)(A) of this section, section 367(a) and (d) will not apply to the extent a domestic corporation (domestic acquired corporation) transfers assets to a foreign corporation (foreign acquiring corporation) in an asset reorganization, and those assets (re-transferred assets) are transferred to a domestic corporation (domestic controlled corporation) in a controlled asset transfer, provided that each of the following conditions is satisfied:

(*i*) The domestic controlled corporation's adjusted basis in the re-transferred assets is not greater than the domestic acquired corporation's adjusted basis in those assets. For this purpose, any increase in basis in the re-transferred assets that results because the domestic acquired corporation recognized gain or income with respect to the re-transferred assets in the transaction is not taken into account.

(*ii*) The domestic acquired corporation includes a statement described in paragraph (d)(2)(vi)(C) of this section with its timely filed U.S. income tax return for the taxable year of the transfer; and

(*iii*) The requirements of paragraphs (c)(1)(i), (ii), and (iv) and (c)(6) of this section are satisfied with respect to the indirect transfer of stock in the domestic acquired corporation.

(*2*) Sections 367(a) and (d) shall not apply to transfers described in paragraph (d)(1)(vi) of this section if a U.S. person transfers assets to a foreign corporation in a section 351 exchange, to the extent that such assets are transferred by such foreign corporation to a domestic corporation in another section 351 exchange, but only if the domestic transferee's adjusted basis in the assets is not greater than the adjusted basis that the U.S. person had in such assets. Any increase in adjusted basis in the assets that results because the U.S. person recognized gain or income with respect to such assets in the initial section 351 exchange is not taken into account for purposes of determining whether the domestic transferee's adjusted basis in the assets is not greater than the U.S. person's adjusted basis in such assets. This paragraph (d)(2)(vi)(B)(*2*) will not, however, apply to an exchange described in section 351 that is also an exchange described in section 361(a) or (b). An exchange described in section 351 that is also an exchange described in section 361(a) or (b) is only eligible for the exception in paragraph (d)(2)(vi)(B)(*1*) of this section.

(C) *Required statement.* The statement required by paragraph (d)(2)(vi)(B)(*1*)(*ii*) of this section shall be entitled ''Required Statement under §1.367(a)–3(d) for Assets Transferred to a Domestic Corporation'' and shall be signed under penalties of perjury by an authorized officer of the domestic acquired corporation and by an authorized officer of the foreign acquiring corporation. The required statement shall contain a certification that, if the foreign acquiring corporation disposes of any stock of the domestic controlled corporation in a transaction described in paragraph (d)(2)(vi)(D) of this section, the domestic acquired corporation shall recognize gain as described in paragraph (d)(2)(vi)(E) of this section. The domestic acquired corporation (or the foreign acquiring corporation on behalf of the domestic acquired corporation) shall file a U.S. income tax return (or an amended U.S. tax return, as the case may be) for the year of the transfer reporting such gain.

(D) *Gain recognition transaction.* (*1*) A transaction described in this paragraph (d)(2)(vi)(D) is one where a principal purpose of the transfer by the domestic acquired corporation is the avoidance of U.S. tax that would have been imposed on the domestic acquired corporation on the disposition of the re-transferred assets. A transfer may have a principal purpose of tax avoidance

even though the tax avoidance purpose is outweighed by other purposes when taken together.

(*2*) For purposes of paragraph (d)(2)(vi)(D)(*1*) of this section, a transaction is deemed to have a principal purpose of tax avoidance if the foreign acquiring corporation disposes of any stock of the domestic controlled corporation (whether in a recognition or non-recognition transaction) within 2 years of the transfer described in paragraph (d)(2)(vi)(A) of this section. The rule in this paragraph (d)(2)(vi)(D)(*2*) shall not apply if the domestic acquired corporation (or the foreign acquiring corporation on behalf of the domestic acquired corporation) demonstrates to the satisfaction of the Commissioner that the avoidance of U.S. tax was not a principal purpose of the transaction. For this purpose, a disposition by the foreign acquiring corporation of stock of the domestic controlled corporation more than 5 years after completion of the transfer described in paragraph (d)(2)(vi)(A) of this section is deemed to not have a principal purpose of tax avoidance.

(E) *Amount of gain recognized and other matters.* (*1*) In the case of a transaction described in paragraph (d)(2)(vi)(D) of this section, solely for purposes of this paragraph (d)(2)(vi)(E), the domestic acquired corporation shall be treated as if, immediately prior to the transfer described in paragraph (d)(2)(vi)(A) of this section, it transferred the re-transferred assets, including any intangible assets, directly to a domestic corporation in exchange for stock of such domestic corporation in a transaction that is treated as a section 351 exchange, and immediately sold such stock to an unrelated party for its fair market value in a sale in which it shall recognize gain, if any (but not loss). Any gain recognized by the domestic acquired corporation pursuant to this paragraph (d)(2)(vi)(E) will increase the basis that the foreign acquiring corporation has in the stock of the domestic controlled corporation immediately before the transaction described in paragraph (d)(2)(vi)(D) of this section, but will not increase the basis of the re-transferred assets held by the domestic controlled corporation. Section 1.367(d)–1T(g)(6) shall not apply with respect to any intangible property included in the re-transferred assets described in this paragraph.

(*2*) If additional tax is required to be paid as a result of a transaction described in paragraph (d)(2)(vi)(D) of this section, then interest must be paid on that amount at rates determined under section 6621 with respect to the period between the date prescribed for filing the domestic acquired corporation's income tax return for the year of the transfer and the date on which the additional tax for that year is paid.

(F) *Examples.* For illustrations of the rules in paragraph (d)(2)(vi) of this section, see paragraph (d)(3) *Examples 6B*, *6C*, *9*, and *13A* of this section.

(vii) *Change in status of a domestic acquired corporation to a foreign corporation.* (A) A U.S. person that exchanges stock or securities of a domestic corporation for stock or securities of a foreign corporation under section 354 (or section 356) will be treated for purposes of this section as having made an indirect stock transfer of the stock or securities of a foreign corporation (and not of a domestic corporation) to a foreign corporation under paragraph (b) of this section (but not paragraph (c) of this section), if the acquired domestic corporation is a subsidiary member (within the meaning of §1.1502–1(c)) of a consolidated group (within the meaning of §1.1502–1(h)) immediately before the transaction, and if the transaction is either of the following:

(*1*) Described in paragraph (d)(1)(i) or (iv) of this section, but only if the acquiring corporation is foreign. See paragraph (d)(3) *Examples 8*, *9*, *10* and *12* of this section.

(*2*) Described in paragraph (d)(1)(v) of this section, but only to the extent the controlled asset transfer is to a foreign corporation. See paragraph (d)(3) *Example 6A* of this section.

(B) The rules of paragraph (d)(2)(vii)(A) of this section will not apply to the extent assets transferred to the foreign acquiring corporation in a transaction described in paragraph (d)(2)(vii)(A)(*1*) of this section, or assets transferred to a foreign corporation in a controlled asset transfer in a transaction described in paragraph (d)(2)(vii)(A)(*2*) of this section, are re-transferred to a domestic controlled

corporation in one or more successive transfers as part of the same transaction. See paragraph (d)(3) *Example 9* of this section.

(3) *Examples.* The rules of this paragraph (d) and §1.367(a)–8 are illustrated by the following examples. For purposes of these examples, assume section 7874 does not apply.

Example 1. Section 368(a)(1)(A)/(a)(2)(D) reorganization. (i) *Facts.* F, a foreign corporation, owns all the stock of Newco, a domestic corporation. A, a domestic corporation, owns all of the stock of W, also a domestic corporation. A and W file a consolidated Federal income tax return. A does not own any stock in F (applying the attribution rules of section 318, as modified by section 958(b)). In a reorganization described in sections 368(a)(1)(A) and (a)(2)(D), Newco acquires all of the assets of W, and A receives 40% of the stock of F in an exchange described in section 354.

(ii) *Result.* Pursuant to paragraph (d)(1)(i) of this section, the reorganization is subject to the indirect stock transfer rules. F is treated as the transferee foreign corporation, and Newco is treated as the transferred corporation. Provided that the requirements of paragraph (c)(1) of this section are satisfied, including the requirement that A enter into a five-year gain recognition agreement as described in §1.367(a)–8, A's exchange of W stock for F stock under section 354 will not be subject to section 367(a)(1). If F disposes (within the meaning of §1.367(a)–8(j)(1)) of all (or a portion) of Newco's stock within the five-year term of the agreement (and A has not made a valid election under §1.367(a)–8(c)(2)(vi)), A is required to file an amended return for the year of the transfer and include in income, with interest, the gain realized but not recognized on the initial section 354 exchange. If A has made a valid election under §1.367(a)–8(c)(2)(vi) to include the amount subject to the gain recognition agreement in the year of the triggering event, A would instead include the gain on its tax return for the taxable year that includes the triggering event, together with interest.

Example 1A. Transferor is a subsidiary in consolidated group. (i) *Facts.* The facts are the same as in *Example 1,* except that A is owned by P, a domestic corporation, and for the taxable year in which the transaction occurred, P, A and W filed a consolidated Federal income tax return.

(ii) *Result.* Even though A is the U.S. transferor, P is required under §1.367(a)–8(d)(3) and (e)(1)(i) to enter into the gain recognition agreement and comply with the requirements under §1.367(a)–8. If A leaves the P group, the gain recognition agreement would be triggered pursuant to §1.367(a)–8(j)(5), unless the exception provided under §1.367(a)–8(k)(10) applies.

Example 2. Section 368(a)(1)(A)/(a)(2)(E) reorganization. (i) *Facts.*The facts are the same as in *Example 1,* except that Newco merges into W and Newco receives stock of W which it distributes to F in a reorganization described in sections 368(a)(1)(A) and (a)(2)(E). Pursuant to the reorganization, A receives 40 percent of the stock of F in an exchange described in section 354.

(ii) *Result.* The consequences of the transfer are similar to those described in *Example 1.* Pursuant to paragraph (d)(1)(ii) of this section, A is considered to have transferred its W stock to F pursuant to the indirect stock transfer rules. F is treated as the transferee foreign corporation, and W is treated as the transferred corporation. Provided that the requirements of paragraph (c)(1) of this section are satisfied, including the requirement that A enter into a five-year gain recognition agreement as described in §1.367(a)–8, A's exchange of W stock for F stock under section 354 will not be subject to section 367(a)(1).

Example 3. Taxable transaction pursuant to indirect stock transfer rules. (i) *Facts.*The facts are the same as in *Example 1*, except that A receives 55 percent of either the total voting power or the total value of the stock of F in the transaction.

(ii) *Result.* A is required to include in income in the year of the exchange the amount of gain realized on such exchange. See paragraph (c)(1)(i) of this section. If A fails to include the income on its timely-filed return, A will also be liable for the penalty under section 6038B (together with interest and other applicable penalties) unless A's failure to include the income is due to reasonable cause and not willful neglect. See §1.6038B–1(f).

Example 4. Disposition by U.S. transferred corporation of substantially all of its assets. (i) *Facts.* The facts are the same as in *Example 1,* except that, during the third year of the gain recognition agreement, Newco disposes of substantially all (as described in§1.367(a)–8(j)(2)(i)) of the assets described in paragraph (d)(2)(v)(A) of this section for cash and recognizes currently all of the gain realized on the disposition.

(ii) *Result.* Under §1.367(a)–8(j)(2), the gain recognition agreement is generally triggered when the transferred corporation disposes of substantially all of its assets. However, under the special rule contained in §1.367(a)–8(o)(4), because A owned an amount of stock in W described in section 1504(a)(2) immediately before the transaction, because A and W filed a consolidated Federal income tax return prior to the transaction, and Newco, the transferred corporation, is a domestic corporation, the gain recognition agreement is terminated and has no further effect.

Example 5. Triangular section 368(a)(1)(B) reorganization. (i) *Facts.* F, a foreign corporation, owns all the stock of S, a domestic corporation. U, a domestic corporation, owns all of the stock of Y, also a domestic corporation. U does not own any of the stock of F (applying the attribution rules of section 318, as modified by section 958(b)). In a triangular reorganization described in section 368(a)(1)(B) and paragraph (d)(1)(iii)(A) of this section, S acquires all the stock of Y, and U receives 10% of the voting stock of F.

(ii) *Result.* U's exchange of Y stock for F stock will not be subject to section 367(a)(1), provided that all of the requirements of paragraph (c)(1) are satisfied, including the requirement that U enter into a five-year gain recognition agreement. For purposes of this section, F is treated as the transferee foreign corporation and Y is treated as the transferred corporation. See paragraphs (d)(2)(i) and (ii) of this section. Under §1.367(a)–8(j)(9), the gain recognition agreement would be triggered if F sold all or a portion of the stock of S.

Example 5A. Triangular section 368(a)(1)(B) reorganization. (i) *Facts.* The facts are the same as in *Example 5*, except that F is a domestic corporation and S is a foreign corporation.

(ii) *Result.* U's exchange of Y stock for stock of F, a domestic corporation in control of S, the foreign acquiring corporation, is treated as an indirect transfer of Y stock to a foreign corporation under paragraph (d)(1)(iii)(B) of this section. U's exchange of Y stock for F stock will not be subject to section 367(a)(1) provided that all of the requirements of paragraph (c)(1) of this section are satisfied, including the requirement that U enter into a five-year gain recognition agreement. In satisfying the 50 percent or less ownership requirements of paragraphs (c)(1)(i) and (ii) of this section, U's indirect ownership of S stock (through its direct ownership of F) will determine whether the requirement of paragraph (c)(1)(i) of this section is satisfied and will be taken into account in determining whether the requirement of paragraph (c)(1)(ii) of this section is satisfied. See paragraph (c)(4)(iv) of this section. For purposes of this section, S is treated as the transferee foreign corporation (see paragraph (d)(2)(i)(B) of this section). If Y sold substantially all of its assets (within the meaning of section 368(a)(1)(C)), the gain recognition agreement would be terminated because U owned an amount of stock in Y described in section 1504(a)(2) immediately before the transaction and Y is a domestic corporation. See §1.367(a)–8(o)(4).

Example 6. Triangular section 368(a)(1)(C) reorganization. (i) *Facts.* F, a foreign corporation, owns all of the stock of R, a domestic corporation that operates an historical business. V, a domestic corporation, owns all of the stock of Z, also a domestic corporation. V does not own any of the stock of F (applying the attribution rules of section 318 as modified by section 958(b)). In a triangular reorganization described in section 368(a)(1)(C) (and paragraph (d)(1)(iv) of this section), R acquires all of the assets of Z, and V receives 30% of the voting stock of F.

(ii) *Result.* The consequences of the transfer are similar to those described in *Example 1*; V is required to enter into a 5-year gain recognition agreement under §1.367(a)–8 to secure nonrecognition treatment under section 367(a). Under paragraphs (d)(2)(i) and (ii) of this section, F is treated as the transferee foreign corporation and R is treated as the transferred corporation. In determining whether, in a later transaction, R has disposed of substantially all of its assets under §1.367(a)–8(j)(2)(i), see paragraph (d)(2)(v)(A) of this section.

Example 6A. Section 368(a)(1)(C) reorganization followed by section 368(a)(2)(C) exchange. (i) *Facts.* The facts are the same as in *Example 6*, except that the transaction is structured as a section 368(a)(1)(C) reorganization with Z transferring its assets to F, followed by a controlled asset transfer, and R is a foreign corporation. The following additional facts are present. Z has 3 businesses: Business A with a basis of $10 and a value of $50, Business B with a basis of $10 and a value of $40, and Business C with a basis of $10 and a value of $30. V and Z file a consolidated Federal income tax return and V has a basis of $30 in the Z stock, which has a value of $120. Assume that Businesses A and B consist solely of assets that will satisfy the section 367(a)(3) active trade or business exception; none of Business C's assets will satisfy the exception. Z transfers all 3 businesses to F in exchange for 30 percent of the F stock, which Z distributes to V pursuant to a section 368(a)(1)(C) reorganization. F then contributes Businesses B and C to R in a controlled asset transfer.

(ii) *Result.* The transfer of the Business A assets by Z to F does not constitute an indirect stock transfer under paragraph (d) of this section, and, subject to the conditions and requirements of section 367(a)(5) and §1.367(a)–7(c), the Business A assets qualify for the section 367(a)(3) active trade or business exception and are not subject to section 367(a)(1). The transfer of the Business B and C assets by Z to F must first be tested under sections 367(a)(1), (a)(3), and (a)(5). Z recognizes $20 of gain on the outbound transfer of the Business C assets, as those assets do not qualify for an exception to section 367(a)(1). Subject to the conditions and requirements of section 367(a)(5) and §1.367(a)–7(c), the Business B assets qualify for the active trade or business exception under section 367(a)(3). Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(*2*) of this section, V is deemed to transfer the stock of a foreign corporation to F in a section 354 exchange subject to the

rules of paragraphs (b) and (d) of this section. V must enter into the gain recognition agreement in the amount of $30 to preserve Z's nonrecognition treatment with respect to its transfer of Business B assets. Under paragraphs (d)(2)(i) and (d)(2)(ii) of this section, F is the transferee foreign corporation and R is the transferred corporation.

Example 6B. Section 368(a)(1)(C) reorganization followed by a controlled asset transfer to a domestic controlled corporation—(i) *Facts.* The facts are the same as in paragraph (d)(3), *Example 6A,* of this section, except that R is a domestic corporation.

(ii) *Result.* As in paragraph (d)(3), *Example 6A,* of this section, the outbound transfer of the Business A assets to F is not affected by the rules of §1.367–3(d) and is subject to the general rules under section 367. Subject to the conditions and requirements of section 367(a)(5) and §1.367(a)–7(c), the Business A assets qualify for the section 367(a)(3) active trade or business exception and are not subject to section 367(a)(1). The Business B and C assets are part of an indirect stock transfer under §1.367–3(d), but must first be tested under section 367(a) and (d). The Business B assets qualify for the active trade or business exception under section 367(a)(3); the Business C assets do not. However, pursuant to paragraph (d)(2)(vi)(B)(*1*) of this section, the Business B and C assets are not subject to section 367(a) or (d), provided that the basis of the Business B and C assets in the hands of R is not greater than the basis of the assets in the hands of Z, the requirements of paragraphs (c)(1)(i), (ii), and (iv) and (c)(6) of this section are satisfied, and Z attaches a statement described in paragraphs (d)(2)(vi)(C) of this section to its U.S. income tax return for the taxable year of the transfer. V also is deemed to make an indirect transfer of Z stock under the rules of paragraph (d) of this section to the extent the assets are transferred to R. To preserve non-recognition treatment, and assuming the other requirements of paragraph (c) of this section are satisfied, V must enter into a gain recognition agreement in the amount of $50, which equals the aggregate gain in the Business B and C assets, because the transfer of those assets by Z was not taxable under section 367(a)(1) and constitute an indirect stock transfer.

Example 6C. Section 368(a)(1)(C) reorganization followed by a controlled asset transfer to a domestic controlled corporation—(i) *Facts.* The facts are the same as in paragraph (d)(3), *Example 6B,* of this section, except that Z is owned by U.S. individuals, none of whom qualify as five-percent target shareholders with respect to Z within the meaning of paragraph (c)(5)(iii) of this section. The following additional facts are present. No U.S. persons that are either officers or directors of Z own any stock of F immediately after the transfer. F is engaged in an active trade or business outside the United States that satisfies the test set forth in paragraph (c)(3) of this section.

(ii) *Result.* The Business A assets transferred to F are not re-transferred to R and therefore Z's transfer of these assets is not subject to the rules of paragraph (d) of this section. However, gain must be recognized on the transfer of those assets under section 367(a)(1) because the section 367(a)(3) active trade or business exception is inapplicable pursuant to section 367(a)(5) and §1.367(a)–7(b). The Business B and C assets are part of an indirect stock transfer under paragraph (d) of this section, but must first be tested with respect to Z under section 367(a) and (d), as provided in paragraph (d)(2)(vi) of this section. The transfer of the Business B assets (which otherwise would satisfy the section 367(a)(3) active trade or business exception) generally is subject to section 367(a)(1) pursuant to section 367(a)(5) and §1.367(a)–7(b). The transfer of the Business C assets generally is subject to section 367(a)(1) because these assets do not qualify for the active trade or business exception under section 367(a)(3). However, pursuant to paragraph (d)(2)(vi)(B) of this section, the transfer of the Business B and C assets is not subject to sections 367(a)(1) and (d), provided the basis of the Business B and C assets in the hands of R is no greater than the basis in the hands of Z and certain other requirements are satisfied. Z may avoid immediate gain recognition under section 367(a) and (d) on the transfers of the Business B and Business C assets to F if, pursuant to paragraph (d)(2)(vi)(B) of this section, the indirect transfer of Z stock satisfies the requirements of paragraphs (c)(1)(i), (ii), and (iv) and (c)(6) of this section, and Z attaches a statement described in paragraph (d)(2)(vi)(C) of this section to its U.S. income tax return for the taxable year of the transfer. In general, the statement must contain a certification that, if F disposes of the stock of R (in a recognition or nonrecognition transaction) and a principal purpose of the transfer is the avoidance of U.S. tax that would have been imposed on Z on the disposition of the Business B and C assets transferred to R, then Z (or F on behalf of Z) will file a return (or amended return as the case may be) recognizing gain ($50), as if, immediately prior to the reorganization, Z transferred the Business B and C assets to a domestic corporation in exchange for stock in a transaction treated as a section 351 exchange and immediately sold such stock to an unrelated party for its fair market value. A transaction is deemed to have a principal purpose of U.S. tax avoidance if F disposes of R stock within two years of the transfer, unless Z (or F on behalf of Z) can rebut the presumption to the satisfaction of the Commissioner. See paragraph (d)(2)(vi)(D)(*2*) of this section. With respect to the indirect transfer of Z stock, assume

the requirements of paragraphs (c)(1)(i), (ii), and (iv) of this section are satisfied. Thus, assuming Z attaches the statement described in paragraph (d)(2)(vi)(C) of this section to its U.S. income tax return and satisfies the reporting requirements of paragraph (c)(6) of this section, the transfer of Business B and C assets is not subject to immediate gain recognition under section 367(a) or (d).

Example 7. Triangular section 368(a)(1)(C) reorganization followed by 351 exchange. (i) *Facts.* The facts are the same as in *Example 6,* except that, during the fourth year of the gain recognition agreement, R transfers substantially all of the assets received from Z to K, a wholly-owned domestic subsidiary of R, in an exchange described in section 351.

(ii) *Result.* The disposition by R, the transferred corporation, of substantially all of its assets would terminate the gain recognition agreement if the assets were disposed of in a taxable transaction because V owned an amount of stock in Z described in section 1504(a)(2) immediately before the transaction, and R is a domestic corporation. See §1.367(a)–8(o)(4). Because the assets were transferred in an exchange to which section 351 applies, such transfer does not trigger the gain recognition agreement if V complies with the requirements contained in §1.367(a)–8(k)(4). See also paragraph (d)(2)(iv) of this section. To determine whether substantially all of the assets are disposed of, any assets of Z that were transferred by Z to R and then contributed by R to K are taken into account.

Example 7A. Triangular section 368(a)(1)(C) reorganization followed by section 351 exchange with foreign transferee. (i) *Facts.* The facts are the same as in *Example 7* except that K is a foreign corporation.

(ii) *Result.* This transfer of assets by R to K must be analyzed to determine its effect upon the gain recognition agreement, and such transfer is also an outbound transfer of assets that is taxable under section 367(a)(1) unless the active trade or business exception under section 367(a)(3) applies. If the transfer is fully taxable under section 367(a)(1), the transfer is treated as if the transferred company, R, sold substantially all of its assets. Thus, the gain recognition agreement would terminate because V owned an amount of stock in Z described in section 1504(a)(2) immediately before the transaction, and R is a domestic corporation. See §1.367(a)–8(o)(4). If each asset transferred qualifies for nonrecognition treatment under section 367(a)(3) and the regulations thereunder (which require, under §1.367(a)–2T(a)(2), the transferor to comply with the reporting requirements under section 6038B), the result is the same as in *Example 7.* If a portion of the assets transferred qualify for nonrecognition treatment under section 367(a)(3) and a portion are taxable under section 367(a)(1) (but such portion does not result in the disposition of substantially all of the assets), the gain recognition agreement will not be triggered if such information is reported as required under §1.367(a)–8(g) and V satisfies the requirements contained in §1.367(a)–8(k)(4).

Example 8. Concurrent application of asset transfer and indirect stock transfer rules in consolidated return setting. (i) *Facts.* Assume the same facts as in *Example 6*, except that R is a foreign corporation and V and Z file a consolidated return for Federal income tax purposes. The properties of Z consist of Business A assets, with an adjusted basis of $50 and fair market value of $90, and Business B assets, with an adjusted basis of $50 and a fair market value of $110. Assume that the Business A assets do not qualify for the active trade or business exception under section 367(a)(3), but that the Business B assets do qualify for the exception. V's basis in the Z stock is $100, and the value of such stock is $200.

(ii) *Result.* Under paragraph (d)(2)(vi), the assets of Businesses A and B that are transferred to R must be tested under sections 367(a)(3) and (a)(5) prior to consideration of the indirect stock transfer rules of this paragraph (d). Thus, Z must recognize $40 of income under section 367(a)(1) on the outbound transfer of Business A assets. Subject to the conditions and requirements of section 367(a)(5) and §1.367(a)–7(c), the Business B assets qualify for the active trade or business exception under section 367(a)(3). Under §1.1502–32, because V and Z file a consolidated return, V's basis in its Z stock increases from $100 to $140 as a result of Z's $40 gain. Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)*(1)* of this section, V is deemed to transfer the stock of a foreign corporation to F in a section 354 exchange subject to the rules of paragraphs (b) and (d) of this section, and therefore must enter into a gain recognition agreement in the amount of $60 (the gain realized but not recognized by V in the stock of Z after the $40 basis adjustment). If F sells a portion of its stock in R during the term of the agreement, V will be required to recognize a portion of the $60 gain subject to the agreement. To determine whether R disposes of substantially all of its assets (under §1.367(a)–8(j)(2)(i)), only the Business B assets will be considered (because the transfer of the Business A assets was taxable to Z under section 367). See paragraph (d)(2)(v)(A) of this section.

Example 8A. Concurrent application without consolidated returns. (i) *Facts.* The facts are the same as in *Example 8*, except that V and Z do not file consolidated income tax returns.

(ii) *Result.* Z would still recognize $40 of gain on the transfer of its Business A assets, and the Business B assets would still qualify for the active trade or business exception under section 367(a)(3). However, V's basis in its stock of Z would not be increased by the

amount of Z's gain. V's indirect transfer of stock will be taxable unless V enters into a gain recognition agreement (as described in §1.367(a)–8) for the $100 of gain realized but not recognized with respect to the stock of Z.

Example 8B. Concurrent application with individual U.S. shareholder. (i) *Facts.* The facts are the same as in *Example 8,* except that V is an individual U.S. citizen.

(ii) *Result.* Under section 367(a)(5) and §1.367(a)–7(b), the active trade or business exception under section 367(a)(3) does not apply to Z's transfer of assets to R. Thus, Z's transfer of assets to R would be fully taxable under section 367(a)(1). Z would recognize $100 of income. V's basis in its stock of Z is not increased by this amount. V is taxable with respect to its indirect transfer of its Z stock unless V enters into a gain recognition agreement in the amount of the $100, the gain realized but not recognized with respect to its Z stock.

Example 8C. Concurrent application with nonresident alien shareholder. (i) *Facts.* The facts are the same as in *Example 8,* except that V is a nonresident alien.

(ii) *Result.* Under section 367(a)(5) and §1.367(a)–7(b), the active trade or business exception under section 367(a)(3) does not apply to Z's transfer of assets to R. Thus, Z has $100 of gain with respect to the Business A and B assets. Because V is a nonresident alien, however, V is not subject to section 367(a) with respect to its indirect transfer of Z stock.

Example 9. Indirect stock transfer by reason of a controlled asset transfer—(i) *Facts.* The facts are the same as in paragraph (d)(3), *Example 8,* of this section, except that R transfers the Business A assets to M, a wholly owned domestic subsidiary of R, in a controlled asset transfer. In addition, V's basis in its Z stock is $90.

(ii) *Result.* Pursuant to paragraph (d)(2)(vi)(B) of this section, sections 367(a) and (d) do not apply to Z's transfer of the Business A assets to R if M's basis in the Business A assets is not greater than the basis of the assets in the hands of Z, the requirements of paragraphs (c)(1)(i), (ii), and (iv) and (c)(6) of this section are satisfied, and Z includes a statement described in paragraph (d)(2)(vi)(C) of this section with its U.S. income tax return for the taxable year of the transfer. Subject to the conditions and requirements of section 367(a)(5) and §1.367(a)–7(c), Z's transfer of the Business B assets to R (which are not re-transferred to M) qualifies for the active trade or business exception under section 367(a)(3). Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)*(1)* of this section, V is generally deemed to transfer the stock of a foreign corporation to F in a section 354 exchange subject to the rules of paragraphs (b) and (d) of this section, including the requirement that V enter into a gain recognition agreement and comply with the requirements of §1.367(a)–8. However, pursuant to paragraph (d)(2)(vii)(B) of this section, paragraph (d)(2)(vii)(A) of this section does not apply to the extent of the transfer of business A assets by R to M, a domestic corporation. As a result, to the extent of the business A assets transferred by R to M, V is deemed to transfer the stock of Z (a domestic corporation) to F in a section 354 exchange subject to the rules of paragraphs (c) and (d) of this section. Thus, with respect to V's indirect transfer of stock of a domestic corporation to F, such transfer is not subject to gain recognition under section 367(a)(1) if the requirements of paragraph (c) of this section are satisfied, including the requirement that V enter into a gain recognition agreement (separate from the gain recognition agreement described above with respect to the deemed transfer of stock of a foreign corporation to F) and comply with the requirements of §1.367(a)–8. Under paragraphs (d)(2)(i) and (ii) of this section, the transferee foreign corporation is F and the transferred corporation is R (with respect to the transfer of stock of a foreign corporation) and M (with respect to the transfer of stock of a domestic corporation). Pursuant to paragraph (d)(2)(iv) of this section, a disposition by F of the stock of R would trigger both gain recognition agreements. In addition, a disposition by R of the stock of M would trigger the gain recognition agreement filed with respect to the transfer of the stock of a domestic corporation. To determine whether there is a triggering event under §1.367(a)–8(j)(2)(i) for the gain recognition agreement filed with respect to the transfer of stock of the domestic corporation, the Business A assets in M must be considered. To determine whether there is such a triggering event for the gain recognition agreement filed with respect to the transfer of stock of the foreign corporation, the Business B assets in R must be considered.

Example 10. Concurrent application of asset transfer and indirect stock transfer rules in section 368(a)(1)(A)/(a)(2)(D) reorganization. (i) *Facts.* The facts are the same as in Example 8, except that R acquires all of the assets of Z in a reorganization described in sections 368(a)(1)(A) and (a)(2)(D). Pursuant to the reorganization, V receives 30 percent of the stock of F in a section 354 exchange.

(ii) *Result.* The consequences of the transaction are similar to those in *Example 8.* The assets of Businesses A and B that are transferred to R must be tested under section 367(a) and (d) prior to the consideration of the indirect stock transfer rules of this paragraph (d). Subject to the conditions and requirements of section 367(a)(5) and §1.367(a)–7(c), the Business B assets qualify for the active trade or business exception under section 367(a)(3). Because the Business A assets

do not qualify for the exception, Z must recognize $40 of gain under section 367(a) on the transfer of Business A assets to R. Further, because V and Z file a consolidated return, V's basis in the stock of Z is increased from $100 to $140 as a result of Z's $40 gain. Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(*1*) of this section, V is deemed to transfer the stock of a foreign corporation to F in a section 354 exchange subject to the rules of paragraphs (b) and (d) of this section. V's indirect transfer of foreign stock will be taxable under section 367(a) unless V enters into a gain recognition agreement in the amount of $60 ($200 value of Z stock less $140 adjusted basis).

Example 11. Concurrent application of section 367(a) and (b) in section 368(a)(1)(A)/(a)(2)(E) reorganization. (i) *Facts.* F, a foreign corporation, owns all the stock of D, a domestic corporation. V, a domestic corporation, owns all the stock of Z, a foreign corporation. V has a basis of $100 in the stock of Z which has a fair market value of $200. D is an operating corporation with assets valued at $100 with a basis of $60. In a reorganization described in sections 368(a)(1)(A) and (a)(2)(E), D merges into Z, and V exchanges its Z stock for 55 percent of the outstanding F stock.

(ii) *Result.* Under paragraph (d)(1)(ii) of this section, V is treated as indirectly transferring Z stock to F. V must recognize gain on its indirect transfer of Z stock to F under section 367(a) (and section 1248 will be applicable) if V does not enter into a gain recognition agreement with respect to the indirect stock transfer in accordance with §1.367(a)–8. Under paragraph (b)(2) of this section, if V enters into a gain recognition agreement with respect to the indirect stock transfer, the exchange will be subject to the provisions of section 367(b) and the regulations pursuant to such section as well as section 367(a). Under §1.367(b)–4(b), however, no income inclusion is required because, immediately after the exchange, F and Z are controlled foreign corporations with respect to which V is a section 1248 shareholder. Under paragraphs (d)(2)(i) and (d)(2)(ii) of this section, the transferee foreign corporation is F, and the transferred corporation is Z (the acquiring corporation). If F disposes (within the meaning of §1.367(a)–8(j)(1)) of all (or a portion) of Z stock within the term of the gain recognition agreement, V must either file an amended return for the year of the indirect stock transfer and include in income, with interest, the gain realized but not recognized on the initial exchange or if a valid election under §1.367(a)–8(c)(2)(vi) was made, currently recognize the gain and pay the related interest. Under paragraph (d)(2)(v)(B) of this section, to determine whether, for purposes of the gain recognition agreement, Z (the transferred corporation) disposes of substantially all of its assets, only the assets held by Z immediately before the transaction are taken into account. Because D is wholly owned by F, a foreign corporation, the control requirement of section 367(a)(5) and §1.367(a)–7(c)(1) cannot be satisfied. Therefore, section 367(a)(5) and §1.367(a)–7(b) preclude the application of the active trade or business exception under section 367(a)(3) to any property transferred by D to Z. Thus, under section 367(a)(1), D must recognize the gross amount of gain in each asset transferred to Z, or $40.

Example 12. Concurrent application of direct and indirect stock transfer rules. (i) *Facts.* F, a foreign corporation, owns all of the stock of O, also a foreign corporation. D, a domestic corporation, owns all of the stock of E, also a domestic corporation, which owns all of the stock of N, also a domestic corporation. Prior to the transactions described in this *Example 12,* D, E and N filed a consolidated income tax return. D has a basis of $100 in the stock of E, which has a fair market value of $160. The N stock has a fair market value of $100, and E has a basis of $60 in such stock. In addition to the stock of N, E owns the assets of Business X. The assets of Business X have a fair market value of $60, and E has a basis of $50 in such assets. Assume that the Business X assets qualify for nonrecognition treatment under section 367(a)(3). D does not own any stock in F (applying the attribution rules of section 318 as modified by section 958(b)). In a triangular reorganization described in section 368(a)(1)(C) and paragraph (d)(1)(iv) of this section, O acquires all of the assets of E, and D exchanges its stock in E for 40% of the voting stock of F.

(ii) *Result.* E's transfer of its assets, including the N stock, must be tested under the general rules of section 367(a) before consideration of D's indirect transfer of the stock of E. Subject to the conditions and requirements of section 367(a)(5) and §1.367(a)–7(c), the active trade or business exception under section 367(a)(3) applies to E's transfer of Business X assets. E's transfer of its N stock could qualify for nonrecognition treatment if D satisfies the requirements in §1.367(a)–3(e)(3). O is the transferee foreign corporation; N is the transferred corporation. Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(*1*) of this section, D is deemed to transfer the stock of a foreign corporation to F in a section 354 exchange subject to the rules of paragraphs (b) and (d) of this section, and therefore may enter into a gain recognition agreement for such indirect stock transfer as provided in paragraph (b) of this section and §1.367(a)–8. As to this transfer, F is the transferee foreign corporation; O is the transferred corporation.

Example 13. Successive section 351 exchanges. (i) *Facts.* D, a domestic corporation, owns all the stock of X, a controlled foreign corporation that operates an historical business, which owns all the stock of Y, a controlled foreign corporation that also operates an

historical business. The properties of D consist of Business A assets, with an adjusted basis of $50 and a fair market value of $90, and Business B assets, with an adjusted basis of $50 and a fair market value of $110. Assume that the Business B assets qualify for the exception under section 367(a)(3) and §1.367(a)–2T(c)(2), but that the Business A assets do not qualify for the exception. In an exchange described in section 351, D transfers the assets of Businesses A and B to X, and, in connection with the same transaction, X transfers the assets of Business B to Y in another exchange described in section 351.

(ii) *Result.* Under paragraph (d)(1)(vi) of this section, this transaction is treated as an indirect stock transfer for purposes of section 367(a), but the transaction is not recharacterized for purposes of section 367(b). Moreover, under paragraph (d)(2)(vi) of this section, the assets of Businesses A and B that are transferred to X must be tested under section 367(a)(3). The Business A assets, which were not transferred to Y, are subject to the general rules of section 367(a), and not the indirect stock transfer rules described in this paragraph (d). D must recognize $40 of income on the outbound transfer of Business A assets. The transfer of the Business B assets is subject to both the asset transfer rules (under section 367(a)(3)) and the indirect stock transfer rules of this paragraph (d) and §1.367(a)–8. Thus, D's transfer of the Business B assets will not be subject to section 367(a)(1) if D enters into a five-year gain recognition agreement with respect to the stock of Y. Under paragraphs (d)(2)(i) and (ii) of this section, X will be treated as the transferee foreign corporation and Y will be treated as the transferred corporation for purposes of applying the terms of the agreement. If X sells all or a portion of the stock of Y during the term of the agreement, D will be required to recognize a proportionate amount of the $60 gain that was realized by D on the initial transfer of the Business B assets.

Example 13A. Successive section 351 exchanges with ultimate domestic transferee. (i) *Facts.* The facts are the same as in *Example 13,* except that Y is a domestic corporation.

(ii) *Result.* As in *Example 13,* D must recognize $40 of income on the outbound transfer of the Business A assets. Although the Business B assets qualify for the exception under section 367(a)(3) (and end up in U.S. corporate solution, in Y), the $60 of gain realized on the Business B assets is nevertheless taxable under paragraphs (c)(1) and (d)(1)(vi) of this section because the transaction is considered to be a transfer by D of stock of a domestic corporation, Y, in which D receives more than 50 percent of the stock of the transferee foreign corporation, X. A gain recognition agreement is not permitted.

Example 14. Concurrent application of indirect stock transfer rules and section 367(b). (i) *Facts.* F, a foreign corporation, owns all of the stock of Newco, which is also a foreign corporation. P, a domestic corporation, owns all of the stock of S, a foreign corporation that is a controlled foreign corporation within the meaning of section 957(a). P's basis in the stock of S is $50 and the value of S is $100. The section 1248 amount with respect to S stock is $30. In a reorganization described in section 368(a)(1)(C) (and paragraph (d)(1)(iv) of this section), Newco acquires all of the properties of S, and P exchanges its stock in S for 49 percent of the stock of F.

(ii) *Result.* P's exchange of S stock for F stock under section 354 will be taxable under section 367(a) (and section 1248 will be applicable) if P fails to enter into a 5-year gain recognition agreement in accordance with §1.367(a)–8. Under paragraph (b)(2) of this section, if P enters into a gain recognition agreement, the exchange will be subject to the provisions of section 367(b) and the regulations thereunder as well as section 367(a). Under §1.367(b)–4(b), P must recognize the section 1248 amount of $30 because P exchanged stock of a controlled foreign corporation, S, for stock of a foreign corporation that is not a controlled foreign corporation, F. The indirect stock transfer rules do not apply with respect to section 367(b). The deemed dividend of $30 recognized by P will increase P's basis in the F stock received in the transaction, and F's basis in the Newco stock. Thus, the amount of the gain recognition agreement is $20 ($50 gain realized on the transfer less the $30 inclusion under section 367(b)). Under paragraphs (d)(2)(i) and (ii) of this section, F is treated as the transferee foreign corporation and Newco is the transferred corporation.

Example 14A. Triangular section 368(a)(1)(C) reorganization involving foreign acquired corporation. (i) *Facts.* Assume the same facts as in Example 14, except that P receives 51 percent of the stock of F.

(ii) *Result.* Assuming §1.367(b)–4(b) does not apply, there is no income inclusion under section 367(b), and the amount of the gain recognition agreement is $50.

Example 15. Concurrent application of indirect stock transfer rules and section 367(b). (i) *Facts.* F, a foreign corporation, owns all of the stock of Newco, a domestic corporation. P, a domestic corporation, owns all of the stock of FC, a foreign corporation. P's basis in the stock of FC is $50 and the value of FC stock is $100. The all earnings and profits amount with respect to the FC stock held by P is $60. See §1.367(b)–2(d). In a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) (and paragraph (d)(1)(i) of this section), Newco acquires all of the properties of FC, and P exchanges its stock in FC for 20 percent of the stock in F.

(ii) *Result.* P's section 354 exchange is considered an indirect stock transfer under paragraph (d)(1)(i) of this section. Further, because the assets of FC were acquired by Newco, a domestic corporation, in an asset reorganization, the transaction is within §1.367(b)–3(a) and (b). Because the transaction is subject to §1.367(b)–3 and the indirect stock rules of paragraph (d) of this section, and because the all earnings and profits amount with respect to the FC stock exchanged by P ($60) is greater than the gain in such stock subject to section 367(a) ($50), the section 367(b) rules (and not the section 367(a) rules) apply to the exchange. See §1.367(a)–3(b)(2)(i)(B). Under the rules of section 367(b), P must include in income the all earnings and profits amount of $60 with respect to its FC stock. See §1.367(b)–3. Alternatively, if P's all earnings and profits amount with respect to its FC stock were $30 (which is less than the gain in such stock subject to section 367(a) ($50)), section 367(b) and the regulations thereunder would not apply if there is gain recognition under section 367(a). Thus, if P failed to enter into a 5-year gain recognition agreement in accordance with §1.367(a)–8, then P would recognize $50 of gain under section 367(a) and there would be no income inclusion under section 367(b). If, instead, P enters into a 5-year gain recognition agreement under §1.367(a)–8, thereby avoiding immediate gain recognition on the entire $50 of section 367(a) gain, P is required to include in income the all earnings and profits amount of $30. In such a case, P will adjust its basis in the FC stock pursuant to §1.367(b)–2(e)(3)(ii) and enter into a gain recognition agreement in the amount of $20.

Example 16. Direct asset reorganization not subject to stock transfer rules. (i) *Facts.* D is a domestic corporation that owns all the stock of F1 and F2, both foreign corporations. In a reorganization described in section 368(a)(1)(D), F2 acquires all of the assets of F1, and D receives 30 percent of the stock of F2 in an exchange described in section 354.

(ii) *Result.* The section 368(a)(1)(D) reorganization is not an indirect stock transfer described in paragraph (d) of this section. Moreover, the section 354 exchange by D of F1 stock for F2 stock is not an exchange described under section 367(a). See paragraph (a)(2)(ii) of this section.

(e) *Transfers of stock or securities by a domestic corporation to a foreign corporation in a section 361 exchange*—(1) *Overview*—(i) *Scope and definitions.* This paragraph (e) applies to a domestic corporation (U.S. transferor) that transfers stock or securities of a domestic or foreign corporation (transferred stock or securities) to a foreign corporation (foreign acquiring corporation) in a section 361 exchange. Except as otherwise provided in this paragraph (e), paragraphs (b) and (c) of this section do not apply to the U.S. transferor's transfer of the transferred stock or securities in the section 361 exchange. For purposes of this paragraph (e), the definitions of control group, control group member, and non-control group member in §1.367(a)–7(f)(1), ownership interest percentage in §1.367(a)–7(f)(7), section 361 exchange in §1.367(a)–7(f)(8), and U.S. transferor shareholder in §1.367(a)–7(f)(13), apply.

(ii) *Ordering rules.* Except as otherwise provided, this paragraph (e) applies to the transfer of the transferred stock or securities in the section 361 exchange prior to the application of any other provision of section 367 to such transfer. Furthermore, any gain recognized (including gain treated as a deemed dividend pursuant to section 1248(a)) by the U.S. transferor under this paragraph (e) shall be taken into account for purposes of applying any other provision of section 367 (including §§1.367(a)–6, 1.367(a)–7, and 1.367(b)–4) to the transfer of the transferred stock or securities.

(2) *General rule.* Except as provided in paragraph (e)(3) of this section, the transfer by the U.S. transferor of the transferred stock or securities to the foreign acquiring corporation in the section 361 exchange shall be subject to section 367(a)(1), and therefore the U.S. transferor shall recognize any gain (but not loss) realized with respect to the transferred stock or securities. Realized gain is recognized pursuant to the prior sentence notwithstanding that the transfer is described in any other nonrecognition provision enumerated in section 367(a)(1) (such as section 351 or 354).

(3) *Exception.* The general rule of paragraph (e)(2) of this section shall not apply if the conditions of paragraphs (e)(3)(i), (ii), and (iii) of this section are satisfied.

(i) The conditions set forth in §1.367(a)–7(c) are satisfied with respect to the section 361 exchange.

(ii) If the transferred stock or securities are of a domestic corporation, the U.S. target company (as defined in paragraph (c)(1) of this section) complies with the reporting requirements

of paragraph (c)(6) of this section, and the conditions of paragraphs (c)(1)(i), (ii), and (iv) of this section are satisfied with respect to the transferred stock or securities.

(iii) If the U.S. transferor owns (applying the attribution rules of section 318, as modified by section 958(b)) five percent or more of the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer of the transferred stock or securities in the section 361 exchange, then the conditions set forth in paragraphs (e)(3)(iii)(A), (B), and (C) of this section are satisfied.

(A) Except as otherwise provided in this paragraph (e)(3)(iii)(A), each U.S. transferor shareholder that is a qualified U.S. person (as defined in paragraph (e)(6)(vii) of this section) owning (applying the attribution rules of section 318, as modified by section 958(b)) five percent or more of the total voting power or the total value of the stock of the transferee foreign corporation immediately after the reorganization enters into a gain recognition agreement that satisfies the conditions of paragraph (e)(6) of this section and §1.367(a)–8. A U.S. transferor shareholder is not required to enter into a gain recognition agreement pursuant to this paragraph if the amount of gain that would be subject to the gain recognition agreement (as determined under paragraph (e)(6)(i) of this section) is zero.

(B) With respect to non-control group members that are not described in paragraph (e)(3)(iii)(A) of this section, the U.S. transferor recognizes gain equal to the product of the aggregate ownership interest percentage of such non-control group members multiplied by the gain realized by the U.S. transferor on the transfer of the transferred stock or securities.

(C) With respect to each control group member that is not described in paragraph (e)(3)(iii)(A) of this section, the U.S. transferor recognizes gain equal to the product of the ownership interest percentage of such control group member multiplied by the gain realized by the U.S. transferor on the transfer of the transferred stock or securities.

(4) *Application of certain rules at U.S. transferor-level.* For purposes of paragraphs (c)(5)(iii) and (e)(3)(ii) and (iii) of this section, ownership of the stock of the transferee foreign corporation is determined by reference to stock owned by the U.S. transferor immediately after the transfer of the transferred stock or securities to the foreign acquiring corporation in the section 361 exchange, but prior to and without taking into account the U.S. transferor's distribution under section 361(c)(1) of the stock received.

(5) *Transferee foreign corporation*—(i) *General rule.* Except as provided in paragraph (e)(5)(ii) of this section, the transferee foreign corporation for purposes of applying paragraph (e) of this section and §1.367(a)–8 shall be the foreign corporation that issues stock or securities to the U.S. transferor in the section 361 exchange.

(ii) *Special rule for triangular asset reorganizations involving the receipt of stock or securities of a domestic corporation.* In the case of a triangular asset reorganization described in §1.358–(6)(b)(2)(i), (ii), or (iii) or (b)(2)(v) (triangular asset reorganization) in which the U.S. transferor receives stock or securities of a domestic corporation that is in control (within the meaning of section 368(c)) of the foreign acquiring corporation, the transferee foreign corporation shall be the foreign acquiring corporation.

(6) *Special requirements for gain recognition agreements.* A gain recognition agreement filed by a U.S. transferor shareholder pursuant to paragraph (e)(3)(iii)(A) of this section is, in addition to the terms and conditions of §1.367(a)–8, subject to the conditions of this paragraph (e)(6).

(i) The amount of gain subject to the gain recognition agreement shall equal the product of the ownership interest percentage of the U.S. transferor shareholder multiplied by the gain realized by the U.S. transferor on the transfer of the transferred stock or securities, reduced (but not below zero) by the sum of the amounts described in paragraphs (e)(6)(i)(A),(B), (C), and (D) of this section.

(A) Gain recognized by the U.S. transferor with respect to the transferred stock or securities under section

367(a)(1) (including any portion treated as a deemed dividend under section 1248(a)) that is attributable to such U.S. transferor shareholder pursuant to §1.367(a)–7(c)(2) or (e)(5).

(B) A deemed dividend included in the income of the U.S. transferor with respect to the transferred stock under §1.367(b)–4(b)(1)(i) that is attributable to such U.S. transferor shareholder pursuant to §1.367(a)–7(e)(4).

(C) If the U.S. transferor shareholder is subject to an election under §1.1248(f)–2(c)(1), a deemed dividend included in the income of the U.S. transferor pursuant to §1.1248(f)–2(c)(3) that is attributable to the U.S. transferor shareholder.

(D) If the U.S. transferor shareholder is not subject to an election under §1.1248(f)–2(c)(1), the hypothetical section 1248 amount (as defined in §1.1248(f)–1(c)(4)) with respect to the stock of each foreign corporation transferred in the section 361 exchange attributable to the U.S. transferor shareholder.

(ii) The gain recognition agreement shall include the election described in §1.367(a)–8(c)(2)(vi).

(iii) The gain recognition agreement shall designate the U.S. transferor shareholder as the U.S. transferor for purposes of §1.367(a)–8.

(iv) If the transfer of the transferred stock or securities in the section 361 exchange is pursuant to a triangular asset reorganization, the gain recognition agreement shall include appropriate provisions that are consistent with the principles of §1.367(a)–8 for gain recognition agreements involving multiple parties. See §1.367(a)–8(j)(9).

(v) The gain recognition agreement shall not be eligible for termination upon a taxable disposition pursuant to §1.367(a)–8(o)(1) unless the value of the stock or securities received by the U.S. transferor shareholder in exchange for the stock or securities of the U.S. transferor under section 354 or 356 is at least equal to the amount of gain subject to the gain recognition agreement filed by such U.S. transferor shareholder.

(vi) Except as otherwise provided in this paragraph (e)(6)(vi), if gain is subsequently recognized by the U.S. transferor shareholder under the terms of the gain recognition agreement pursuant to §1.367(a)–8(c)(1)(i), the increase in stock basis provided under §1.367(a)–8(c)(4)(i) with respect to the stock received by the U.S. transferor shareholder shall not exceed the amount of the stock basis adjustment made pursuant to §1.367(a)–7(c)(3) with respect to the stock received by the U.S. transferor shareholder. This paragraph (e)(6)(vi) shall not apply if the U.S. transferor shareholder and the U.S. transferor are members of the same consolidated group at the time of the reorganization.

(vii) For purposes of this section, a qualified U.S. person means a U.S. person, as defined in §1.367(a)–1T(d)(1), but for this purpose does not include domestic partnerships, regulated investment companies (as defined in section 851(a)), real estate investment trusts (as defined in section 856(a)), and S corporations (as defined in section 1361(a)).

(7) *Gain subject to section 1248(a).* If the U.S. transferor recognizes gain under paragraphs (e)(3)(iii)(B) or (C) of this section with respect to transferred stock that is stock in a foreign corporation to which section 1248(a) applies, then the portion of such gain treated as a deemed dividend under section 1248(a) is the product of the amount of the gain multiplied by the section 1248(a) ratio. The section 1248(a) ratio is the ratio of the amount that would be treated as a deemed dividend under section 1248(a) if all the gain in the transferred stock were recognized to the amount of gain realized in all the transferred stock.

(8) *Examples.* The following examples illustrate the provisions of paragraph (e) of this section. Except as otherwise indicated: US1, US2, and UST are domestic corporations that are not members of a consolidated group; X is a United States citizen; US1, US2, and X are unrelated parties; CFC1, CFC2, and FA are foreign corporations; each corporation described herein has a single class of stock issued and outstanding and a tax year ending on December 31; the section 1248 amount (within the meaning of §1.367(b)–2(c)) with respect to the stock of CFC1 and CFC2 is zero; Asset A is section 367(a) property that, but for the application of section 367(a)(5), would qualify for the active

foreign trade or business exception under §1.367(a)–2T; the requirements of §1.367(a)–7(c)(2) through (5) are satisfied with respect to a section 361 exchange; the provisions of §1.367(a)–6T (regarding branch loss recapture) are not applicable; and none of the foreign corporations in the examples is a surrogate foreign corporation (within the meaning of section 7874) as a result of the transactions described in the examples because one or more of the conditions of section 7874(a)(2)(B) is not satisfied.

Example 1. U.S. transferor owns less than 5% of stock of transferee foreign corporation—(i) *Facts.* US1, US2, and X own 80%, 5%, and 15%, respectively, of the stock of UST with a fair market value of $160x, $10x, and $30x, respectively. UST has two assets, Asset A and 100% of the stock of CFC1. UST has no liabilities. Asset A has a $150x basis and $100x fair market value (as defined in §1.367(a)–7(f)(3)), and the CFC1 stock has a $0x basis and $100x fair market value. UST transfers Asset A and the CFC1 stock to FA solely in exchange for $200x of FA voting stock in a reorganization described in section 368(a)(1)(C). UST's transfer of Asset A and the CFC1 stock to FA qualifies as a section 361 exchange. UST distributes the FA stock received in the section 361 exchange to US1, US2, and X pursuant to the plan of reorganization, and liquidates. US1 receives $160x of FA stock, US2 receives $10x of FA stock, and X receives $30x of FA stock in exchange for the UST stock. Immediately after the transfer of Asset A and the CFC1 stock to FA in the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock pursuant to section 361(c)(1), UST does not own (applying the attribution rules of section 318, as modified by section 958(b)) five percent or more of the total voting power or the total value of the stock of FA.

(ii) *Result*—(A) UST's transfer of the CFC1 stock to FA in the section 361 exchange is subject to the provisions of this paragraph (e), and this paragraph (e) applies to the transfer of the CFC1 stock prior to the application of any other provision of section 367 to such transfer. See paragraphs (e)(1)(i) and (ii) of this section. Pursuant to the general rule of paragraph (e)(2) of this section, UST must recognize the gain realized of $100x on the transfer of the CFC1 stock (computed as the excess of the $100x fair market value over the $0x basis) unless the requirements for the exception provided in paragraph (e)(3) of this section are satisfied. In this case, the requirements of paragraph (e)(3) of this section are satisfied. First, the requirement of paragraph (e)(3)(i) of this section is satisfied because the control requirement of §1.367(a)–7(c)(1) is satisfied, and a stated assumption is that the requirements of §1.367(a)–7(c)(2) through (5) will be satisfied. The control requirement is satisfied because US1 and US2, each a control group member, own in the aggregate 85% of the stock of UST immediately before the reorganization. Second, the requirement of paragraph (e)(3)(ii) of this section is not applicable because that paragraph applies to the transfer of stock of a domestic corporation and CFC1 is a foreign corporation. Third, paragraph (e)(3)(iii) of this section is not applicable because immediately after the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock pursuant to section 361(c)(1), UST does not own (applying the attribution rules of section 318, as modified by section 958(b)) 5% or more of the total voting power or the total value of the stock of FA. See paragraph (e)(4) of this section. Accordingly, UST does not recognize the $100x of gain realized in the CFC1 stock pursuant to this section.

(B) In order to meet the requirements of §1.367(a)–7(c)(2)(i), UST must recognize gain equal to the portion of the inside gain (as defined in §1.367(a)–7(f)(5)) attributable to non-control group members (X), or $7.50x. The $7.50x of gain is computed as the product of the inside gain ($50x) multiplied by X's ownership interest percentage in UST (15%). Pursuant to §1.367(a)–7(f)(5), the $50x of inside gain is the amount by which the aggregate fair market value ($200x) of the section 367(a) property (as defined in §1.367(a)–7(f)(10), or Asset A and the CFC1 stock) exceeds the sum of the inside basis ($150x) of such property and the product of the section 367(a) percentage (as defined in §1.367(a)–7(f)(9), or 100%) multiplied by UST's deductible liabilities (as defined in §1.367(a)–7(f)(2), or $0x). Pursuant to §1.367(a)–7(f)(4), the inside basis equals the aggregate basis of the section 367(a) property transferred in the section 361 exchange ($150x), increased by any gain or deemed dividends recognized by UST with respect to the section 367(a) property under section 367 ($0x), but not including the $7.50x of gain recognized by UST under §1.367(a)–7(c)(2)(i). Pursuant to §1.367(a)–7(e)(1), the $7.50x of gain recognized by UST is treated as recognized with respect to the CFC1 stock and Asset A in proportion to the amount of gain realized in each. However, because there is no gain realized by UST with respect to Asset A, all $7.50x of the gain is allocated to the CFC1 stock. Furthermore, FA's basis in the CFC1 stock, as determined under section 362 is increased by the $7.50x of gain recognized by UST. See §1.367(a)–1(b)(4)(i)(B).

(C) The requirement to recognize gain under §1.367(a)–7(c)(2)(ii) is not applicable because the portion of the inside gain attributable to US1 and US2 (control group members) can be preserved in the stock received

by each such shareholder. As described in paragraph (ii)(B) of this *Example 1,* the inside gain is $50x. US1's attributable inside gain of $40x (equal to the product of $50x inside gain multiplied by US1's 80% ownership interest percentage, reduced by $0x, the sum of the amounts described in §1.367(a)–7(c)(2)(ii)(A)(*1*) through (*3*)) does not exceed $160x (equal to the product of the section 367(a) percentage of 100% multiplied by $160x fair market value of FA stock received by US1). Similarly, US2's attributable inside gain of $2.50x (equal to the product of $50x inside gain multiplied by US2's 5% ownership interest percentage, reduced by $0x, the sum of the amounts described in §1.367(a)–7(c)(2)(ii)(A)(*1*) through (*3*)) does not exceed $10x (equal to the product of the section 367(a) percentage of 100% multiplied by $10x fair market value of FA stock received by US2).

(D) Each control group member (US1 and US2) must separately compute any required adjustment to stock basis under §1.367(a)–7(c)(3).

Example 2. U.S. transferor owns 5% or more of the stock of the transferee foreign corporation—(i) *Facts.* The facts are the same as in paragraph (e), *Example 1,* of this section except that immediately after the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock pursuant to section 361(c)(1), UST owns (applying the attribution rules of section 318, as modified by section 958(b)) 5% or more of the total voting power or value of the stock of FA. Furthermore, immediately after the reorganization, US1 and X (but not US2) each own (applying the attribution rules of section 318, as modified by section 958(b)) five percent or more of the total voting power or value of the stock of FA.

(ii) *Result*—(A) As is the case with paragraph (e), *Example 1,* of this section, UST's transfer of the CFC1 stock to FA in the section 361 exchange is subject to the provisions of this paragraph (e), and this paragraph (e) applies to the transfer of the CFC1 stock prior to the application of any other provision of section 367 to such transfer. See paragraphs (e)(1)(i) and (ii) of this section. In addition, UST must recognize the gain realized of $100x on the transfer of the CFC1 stock (computed as the excess of the $100x fair market value over the $0x basis) unless the requirements for the exception provided in paragraph (e)(3) of this section are satisfied. For the same reasons provided in *Example 1,* the requirement in paragraph (e)(3)(i) of this section is satisfied and the requirement of paragraph (e)(3)(ii) of this section is not applicable.

(B) Unlike paragraph (e), *Example 1,* of this section, however, UST owns 5% or more of the voting power or value of the stock of FA immediately after the transfer of the CFC1 stock in the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock under section 361(c)(1). As a result, paragraph (e)(3)(iii) of this section is applicable to the section 361 exchange of the CFC1 stock. Accordingly, in order to meet the requirements of paragraph (e)(3)(iii)(A) of this section US1 and X must enter into gain recognition agreements that satisfy the requirements of paragraph (e)(6) of this section and §1.367(a)–8. See paragraph (ii)(G) of this *Example 2* for the computation of the amount of gain subject to each gain recognition agreement.

(C) In order to meet the requirements of paragraph (e)(3)(iii)(C) of this section, UST must recognize $5x of gain attributable to US2 (computed as the product of the $100x of gain realized with respect to the transfer of the CFC1 stock multiplied by the 5% ownership interest percentage of US2). The $5x of gain recognized is not included in the computation of inside basis (see §1.367(a)–7(f)(4)(i)), but reduces (but not below zero) the amount of gain recognized by UST pursuant to §1.367(a)–7(c)(2)(ii) that is attributable to US2. Furthermore, FA's basis in the CFC1 stock as determined under section 362 is increased for the $5x of gain recognized. See §1.367(a)–1(b)(4)(i)(B). Assuming US1 and X enter into the gain recognition agreements described in paragraph (ii)(B) of this *Example 2,* and UST recognizes the $5x of gain described in this example, the requirements of paragraph (e)(3) of this section are satisfied and, accordingly, UST does not recognize the remaining $95x of gain realized in the CFC1 stock pursuant to this section.

(D) As described in paragraph (ii)(B) of *Example 1* of this paragraph (e), UST must recognize $7.50x of gain pursuant to §1.367(a)–7(c)(2)(i), the amount of the $50x of inside gain attributable to X. Pursuant to §1.367(a)–7(e)(1), the $7.50x of gain recognized by UST is treated as recognized with respect to the CFC1 stock and Asset A in proportion to the amount of gain realized in each. However, because there is no gain realized by UST with respect to Asset A, all $7.50x of the gain is allocated to the CFC1 stock. Furthermore, FA's basis in the CFC1 stock as determined under section 362 is increased for the $7.50x of gain recognized. See §1.367(a)–1(b)(4)(i)(B).

(E) As described in paragraph (ii)(C) of *Example 1* of this paragraph (e), the requirement to recognize gain pursuant to §1.367(a)–7(c)(2)(ii) is not applicable because the attributable inside gain of US1 and US2 can be preserved in the stock received by each shareholder. However, if UST were required to recognize gain pursuant to §1.367(a)–7(c)(2)(ii) for inside gain attributable to US2 (for example, if US2 received solely cash rather than FA stock in the reorganization), the amount of such gain would be reduced (but not below zero) by the amount of gain recognized by UST pursuant to paragraph

(e)(3)(iii)(C) of this section that is attributable to US2 (computed as $5x in paragraph (ii)(C) of this *Example 2*). See §1.367(a)–7(c)(2)(ii)(A)(*1*).

(F) Each control group member (US1 and US2) must separately compute any required adjustment to stock basis under §1.367(a)–7(c)(3).

(G) The amount of gain subject to the gain recognition agreement filed by each of US1 and X is determined pursuant to paragraph (e)(6)(i) of this section. With respect to US1, the amount of gain subject to the gain recognition agreement is $80x. The $80x is computed as the product of US1's ownership interest percentage (80%) multiplied by the gain realized by UST in the CFC1 stock as determined prior to taking into account the application of any other provision of section 367 ($100x), reduced by the sum of the amounts described in paragraphs (e)(6)(i)(A) through (D) of this section attributable to US1 ($0x). With respect to X, the amount of gain subject to the gain recognition agreement is $7.50x. The $7.50x is computed as the product of X's ownership interest percentage (15%) multiplied by the gain realized by UST in the CFC1 stock as determined prior to taking into account the application of any other provision of section 367 ($100x), reduced by the sum of the amounts described in paragraphs (e)(6)(i)(A) through (D) of this section attributable to X ($7.50x, as computed in paragraph (ii)(D) of this *Example 2*).

(H) In order the meet the requirements of paragraph (e)(6)(ii) of this section, each gain recognition agreement must include the election described in §1.367(a)–8(c)(2)(vi). Furthermore, pursuant to paragraph (e)(6)(iii) of this section, US1 and X must be designated as the U.S. transferor on their respective gain recognition agreements for purposes of §1.367(a)–8.

Example 3. U.S. transferor owns 5% or more of the stock of the transferee foreign corporation; interaction with section 1248(f)—(i) *Facts.* US1, US2, and X own 50%, 30%, and 20%, respectively, of the stock of UST. The UST stock owned by US1 has a $180x basis and $200x fair market value; the UST stock owned by US2 has a $100x basis and $120x fair market value; and the UST stock owned by X has a $80x fair market value. UST owns Asset A, and all the stock of CFC1 and CFC2. UST has no liabilities. Asset A has a $10x basis and $200x fair market value. The CFC1 stock is a single block of stock (as defined in §1.1248(f)–1(c)(2)) with a $20x basis, $40x fair market value, and $30x of earnings and profits attributable to it for purposes of section 1248 (with the result that the section 1248 amount (as defined in §1.1248(f)–1(c)(9)) is $20x). The CFC2 stock is also a single block of stock with a $30x basis, $160x fair market value, and $150x of earnings and profits attributable to it for purposes of section 1248 (with the result that the section 1248 amount is $130x). On December 31, Year 3, in a reorganization described in section 368(a)(1)(D), UST transfers the CFC1 stock, CFC2 stock, and Asset A to FA in exchange for 60 shares of FA stock with a $400x fair market value. UST's transfer of the CFC1 stock, CFC2 stock, and Asset A to FA in exchange for the 60 shares of FA stock qualifies as a section 361 exchange. UST distributes the FA stock received in the section 361 exchange to US1, US2, and X pursuant to section 361(c)(1). US1, US2, and X exchange their UST stock for 30, 18, and 12 shares, respectively, of FA stock pursuant to section 354. Immediately after the reorganization, FA has 100 shares of stock outstanding, and US1 and US2 are each a section 1248 shareholder with respect to FA.

(ii) *Result*—(A) UST's transfer of the CFC1 stock and CFC2 stock to FA in the section 361 exchange is subject to the provisions of this paragraph (e), and this paragraph (e) applies to the transfer of the CFC1 stock and CFC2 stock prior to the application of any other provision of section 367 to such transfer. See paragraphs (e)(1)(i) and (ii) of this section. Pursuant to the general rule of paragraph (e)(2) of this section, UST must recognize the gain realized of $20x on the transfer of the CFC1 stock (the excess of $40x fair market value over $20x basis) and the gain realized of $130x on the transfer of the CFC2 stock (the excess of $160x fair market value over $30x basis), subject to the application of section 1248(a), unless the requirements for the exception provided in paragraph (e)(3) of this section are satisfied. In this case, the requirement of paragraph (e)(3)(i) of this section is satisfied because the control requirement of §1.367(a)–7(c)(1) is satisfied, and a stated assumption is that the requirements of §1.367(a)–7(c)(2) through (5) will be satisfied. The control requirement is satisfied because US1 and US2, each a control group member, own in the aggregate 80% of the UST stock immediately before the reorganization. The requirement of paragraph (e)(3)(ii) of this section is not applicable because paragraph (e)(3)(ii) applies to the transfer of stock of a domestic corporation, and CFC1 and CFC2 are foreign corporations. UST owns 5% or more of the total voting power or value of the stock of FA (60%, or 60 of the 100 shares of FA stock outstanding) immediately after the transfer of the CFC1 stock and CFC2 stock in the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock under section 361(c)(1). As a result, paragraph (e)(3)(iii) of this section is applicable to the section 361 exchange of the CFC1 stock and CFC2 stock. US1, US2, and X each own (applying the attribution rules of section 318, as modified by section 958(b)) 5% or more of the total voting power or value of the FA stock immediately after the reorganization, or 30%, 18%, and 12%, respectively.

Accordingly, in order to meet the requirements of paragraph (e)(3)(iii)(A) of this section, US1 and US2 must enter into gain recognition agreements with respect to the CFC1 stock and CFC2 stock that satisfy the requirements of paragraph (e)(6) of this section and §1.367(a)–8. X is not required to enter into a gain recognition agreement because the amount of gain that would be subject to the gain recognition agreement is zero. See paragraph (ii)(J) of this *Example 3* for the computation of the amount of gain subject to each gain recognition agreement. Assuming US1 and US2 enter into the gain recognitions agreements described above, the requirements of paragraph (e)(3) of this section are satisfied and accordingly, UST does not recognize the gain realized of $20x in the stock of CFC1 or the gain realized of $130x in the stock of CFC2 pursuant to this section.

(B) UST's transfer of the CFC1 stock and CFC2 stock to FA pursuant to the section 361 exchange is subject to §1.367(b)–4(b)(1)(i), which applies prior to the application of §1.367(a)–7(c). See paragraph (e)(1) of this section. UST (the exchanging shareholder) is a U.S. person and a section 1248 shareholder with respect to CFC1 and CFC2 (each a foreign acquired corporation). However, UST is not required to include in income as a deemed dividend the section 1248 amount with respect to the CFC1 stock ($20x) or CFC2 stock ($130x) under §1.367(b)–4(b)(1)(i) because, immediately after UST's section 361 exchange of the CFC1 stock and CFC2 stock for FA stock (and before the distribution of the FA stock to US1, US2, and X under section 361(c)(1), FA, CFC1, and CFC2 are controlled foreign corporations as to which UST is a section 1248 shareholder. See §1.367(b)–4(b)(1)(ii)(A). However, if UST were required to include in income as a deemed dividend the section 1248 amount with respect to the CFC1 stock or CFC2 stock (for example, if FA were not a controlled foreign corporation), such deemed dividend would be taken into account prior to the application of §1.367(a)–7(c). Furthermore, because US1, US2, and X are all persons described in paragraph (e)(3)(iii)(A) of this section, any such deemed dividend would increase inside basis. See §1.367(a)–7(f)(4).

(C) In order to meet the requirements of §1.367(a)–7(c)(2)(i), UST must recognize gain equal to the portion of the inside gain attributable to non-control group members (X), or $68x. The $68x of gain is computed as the product of the inside gain ($340x) multiplied by X's ownership interest percentage in UST (20%), reduced (but not below zero) by $0x, the sum of the amounts described in §1.367(a)–7(c)(2)(i)(A) through (C). Pursuant to §1.367(a)–7(f)(5), the $340x of inside gain is the amount by which the aggregate fair market value ($400x) of the section 367(a) property (Asset A, CFC1 stock, and CFC2 stock) exceeds the sum of the inside basis ($60x) and $0x (the product of the section 367(a) percentage (100%) multiplied by UST's deductible liabilities ($0x)). Pursuant to §1.367(a)–7(f)(4), the inside basis equals the aggregate basis of the section 367(a) property transferred in the section 361 exchange ($60x), increased by any gain or deemed dividends recognized by UST with respect to the section 367(a) property under section 367 ($0x), but not including the $68x of gain recognized by UST under §1.367(a)–7(c)(2)(i). Under §1.367(a)–7(e)(1), the $68x gain recognized is treated as being with respect to the CFC1 stock, CFC2 stock, and Asset A in proportion to the amount of gain realized by UST on the transfer of the property. The amount treated as recognized with respect to the CFC1 stock is $4x ($68x gain multiplied by $20x/$340x). The amount treated as recognized with respect to the CFC2 stock is $26x ($68x gain multiplied by $130x/$340x). The amount treated as recognized with respect to Asset A is $38x ($68x gain multiplied by $190x/$340x). Under section 1248(a), UST must include in gross income as a dividend the $4x gain recognized with respect to the CFC1 stock and the $26x gain recognized with respect to CFC2 stock. Furthermore, FA's basis in the CFC1 stock, CFC2 stock, and Asset A, as determined under section 362, is increased by the amount of gain recognized by UST with respect to such property. See §1.367(a)–1(b)(4)(i)(B). Thus, FA's basis in the CFC1 stock is $24x ($20x increased by $4x of gain), the CFC2 stock is $56x ($30x increased by $26x of gain), and Asset A is $48x ($10x increased by $38x of gain).

(D) The requirement to recognize gain under §1.367(a)–7(c)(2)(ii) is not applicable because the portion of the inside gain attributable to US1 and US2 (control group members) can be preserved in the stock received by each such shareholder. As described in paragraph (ii)(C) of this Example 3, the inside gain is $340x. US1's attributable inside gain of $170x (equal to the product of $340x inside gain multiplied by US1's 50% ownership interest percentage, reduced by $0x, the sum of the amounts described in §1.367(a)–7(c)(2)(ii)(A)(*1*) through (*3*)) does not exceed $200x (equal to the product of the section 367(a) percentage of 100% multiplied by $200x fair market value of FA stock received by US1). Similarly, US2's attributable inside gain of $102x (equal to the product of $340x inside gain multiplied by US2's 30% ownership interest percentage, reduced by $0x, the sum of the amounts described in §1.367(a)–7(c)(2)(ii)(A)(*1*) through (*3*)) does not exceed $120x (equal to the product of the section 367(a) percentage of 100% multiplied by $120x fair market value of FA stock received by US2).

(E) Each control group member (US1 and US2) separately computes any required adjustment to stock basis under §1.367(a)–

7(c)(3). US1's section 358 basis in the FA stock received of $180x (equal to US1's basis in the UST stock exchanged) is reduced to preserve the attributable inside gain with respect to US1, less any gain recognized with respect to US1 under §1.367(a)–7(c)(2)(ii). Because UST does not recognize gain on the section 361 exchange with respect to US1 under §1.367(a)–7(c)(2)(ii) (as determined in paragraph (ii)(D) of this *Example 3*), the attributable inside gain of $170x with respect to US1 is not reduced under §1.367(a)–7(c)(3)(i)(A). US1's outside gain (as defined in §1.367(a)–7(f)(6)) in the FA stock is $20x, the product of the section 367(a) percentage (100%) multiplied by the $20x gain (equal to the difference between $200x fair market value and $180x section 358 basis in the FA stock). Thus, US1's $180x section 358 basis in the FA stock must be reduced by $150x (the excess of $170x attributable inside gain, reduced by $0x, over $20x outside gain) to $30x. Similarly, US2's section 358 basis in the FA stock received of $100x (equal to US2's basis in the UST stock exchanged) is reduced to preserve the attributable inside gain with respect to US2, less any gain recognized with respect to US2 under §1.367(a)–7(c)(2)(ii). Because UST does not recognize gain on the section 361 exchange with respect to US2 under §1.367(a)–7(c)(2)(ii) (as determined in paragraph (ii)(D) of this *Example 3*), the attributable inside gain of $102x with respect to US2 is not reduced under §1.367(a)–7(c)(3)(i)(A). US2's outside gain in the FA stock is $20x, the product of the section 367(a) percentage (100%) multiplied by the $20x gain (equal to the difference between $120x fair market value and $100x section 358 basis in FA stock). Thus, US2's $100x section 358 basis in the FA stock must be reduced by $82x (the excess of $102x attributable inside gain, reduced by $0x, over $20x outside gain) to $18x.

(F) UST's distribution of the FA stock to US1, US2, and X under section 361(c)(1) (new stock distribution) is subject to §1.1248(f)–1(b)(3). Except as provided in §1.1248(f)–2(c), under §1.1248(f)–1(b)(3) UST must include in gross income as a dividend the total section 1248(f) amount (as defined in §1.1248(f)–1(c)(14)). The total section 1248(f) amount is $120x, the sum of the section 1248(f) amount (as defined in §1.1248(f)–1(c)(10)) with respect to the CFC1 stock ($16x) and CFC2 stock ($104x). The $16x section 1248(f) amount with respect to the CFC1 stock is the amount that UST would have included in income as a dividend under §1.367(b)–4(b)(1)(i) with respect to the CFC1 stock if the requirements of §1.367(b)–4(b)(1)(ii)(A) had not been satisfied ($20x), reduced by the amount of gain recognized by UST under §1.367(a)–7(c)(2) allocable to the CFC1 stock and treated as a dividend under section 1248(a) ($4x, as described in paragraph (ii)(C) of this *Example 3*). Similarly, the section 1248(f) amount with respect to the CFC2 stock is $104x ($130x reduced by $26x).

(G) If, however, UST along with US1 and US2 (each a section 1248 shareholder of FA immediately after the distribution) elect to apply the provisions of §1.1248(f)–2(c) (as provided in §1.1248(f)–2(c)(1)), the amount that UST is required to include in income as a dividend under §1.1248(f)–1(b)(3) ($120x total section 1248(f) amount as computed in paragraph (ii)(F) of this *Example 3*) is reduced by the sum of the portions of the section 1248(f) amount with respect to the CFC1 stock and CFC2 stock that is attributable (under the rules of §1.1248(f)–2(d)) to the FA stock distributed to US1 and US2. Assume that the election is made to apply §1.1248(f)–2(c).

(1) Under §1.1248(f)–2(d)(1), the portion of the section 1248(f) amount with respect to the CFC1 stock that is attributed to the 30 shares of FA stock distributed to US1 is equal to the hypothetical section 1248 amount (as defined in §1.1248(f)–1(c)(4)) with respect to the CFC1 stock that is attributable to US1's ownership interest percentage in UST. US1's hypothetical section 1248 amount with respect to the CFC1 stock is the amount that UST would have included in income as a deemed dividend under §1.367(b)–4(b)(1)(i) with respect to the CFC1 stock if the requirements of §1.367(b)–4(b)(1)(ii)(A) had not been satisfied ($20x) and that would be attributable to US1's ownership interest percentage in UST (50%), reduced by the amount of gain recognized by UST under §1.367(a)–7(c)(2) attributable to US1 and allocable to the CFC1 stock, but only to the extent such gain is treated as a dividend under section 1248(a) ($0x, as described in paragraphs (ii)(C) and (D) of this *Example 3*). Thus, US1's hypothetical section 1248 amount with respect to the CFC1 stock is $10x ($20x multiplied by 50%, reduced by $0x). The $10x hypothetical section 1248 amount is attributed pro rata (based on relative values) among the 30 shares of FA stock distributed to US1, and the attributable share amount (as defined in §1.1248(f)–2(d)(1)) is $.33x ($10x/30 shares). Similarly, US1's hypothetical section 1248 amount with respect to the CFC2 stock is $65x ($130x multiplied by 50%, reduced by $0x), and the attributable share amount is $2.17x ($65x/30 shares). Similarly, US2's hypothetical section 1248 amount with respect to the CFC1 stock is $6x ($20x multiplied by 30%, reduced by $0x), and the attributable share amount is also $.33x ($6x/18 shares). Finally, US2's hypothetical section 1248 amount with respect to the CFC2 stock is $39x ($130x multiplied by 30%, reduced by $0x), and the attributable share amount is also $2.17x ($39x/18 shares). Thus, the sum of the portion of the section 1248(f) amount with respect to the CFC1 stock and CFC2 stock attributable to shares of stock of FA distributed to US1 and US2 is $120x ($10x plus $65x plus $6x plus $39x).

(*2*) If the shares of FA stock are divided into portions, §1.1248(f)–2(d)(2) applies to attribute the attributable share amount to portions of shares of FA stock distributed to US1 and US2. Under §1.1248(f)–2(c)(2) each share of FA stock received by US1 (30 shares) and US2 (18 shares) is divided into three portions, one attributable to the single block of stock of CFC1, one attributable to the single block of stock of CFC2, and one attributable to Asset A. Thus, the attributable share amount of $.33x with respect to the CFC1 stock is attributed to the portion of each of the 30 shares and 18 shares of FA stock received by US1 and US2, respectively, that relates to the CFC1 stock. Similarly, the attributable share amount of $2.17x with respect to the CFC2 stock is attributed to the portion of each of the 30 shares and 18 shares of FA stock received by US1 and US2, respectively, that relates to the CFC2 stock.

(*3*) The total section 1248(f) amount ($120x) that UST is otherwise required to include in gross income as a dividend under §1.1248(f)–1(b)(3) is reduced by $120x, the sum of the portions of the section 1248(f) amount with respect to the CFC1 stock and CFC2 stock that are attributable to the shares of FA stock distributed to US1 and US2. Thus, the amount DC is required to include in gross income as a dividend under §1.1248(f)–1(b)(3) is $0x ($120x reduced by $120x).

(H) As stated in paragraph (ii)(G)(*2*) of this *Example 3,* under §1.1248(f)–2(c)(2) each share of FA stock received by US1 (30 shares) and US2 (18 shares) is divided into three portions, one attributable to the CFC1 stock, one attributable to the CFC2 stock, and one attributable to Asset A. Under §1.1248(f)–2(c)(4)(i), the basis of each portion is the product of US1's and US2's section 358 basis in the share of FA stock multiplied by the ratio of the section 362 basis of the property (CFC1 stock, CFC2 stock, or Asset A, as applicable) received by FA in the section 361 exchange to which the portion relates, to the aggregate section 362 basis of all property received by FA in the section 361 exchange. Under §1.1248(f)–2(c)(4)(ii), the fair market value of each portion is the product of the fair market value of the share of FA stock multiplied by the ratio of the fair market value of the property (CFC1 stock, CFC2 stock, or Asset A, as applicable) to which the portion relates, to the aggregate fair market value of all property received by FA in the section 361 exchange. The section 362 basis of the CFC1 stock, CFC2 stock, and Asset A is $24x, $56x, and $48x, respectively, for an aggregate section 362 basis of $128x. See paragraph (ii)(C) of this *Example 3.* The fair market value of the CFC1 stock, CFC2 stock, and Asset A is $40x, $160x, and $200x, for an aggregate fair market value of $400x. Furthermore, US1's 30 shares of FA stock have an aggregate fair market value of $200x and section 358 basis of $30x (resulting in aggregate gain of $170x), and US2's 18 shares of FA stock have an aggregate fair market value of $120x and section 358 basis of $18x (resulting in aggregate gain of $102x). See paragraph (ii)(E) of this *Example 3.*

(*1*) With respect to US1's 30 shares of FA stock, the portions attributable to the CFC1 stock have an aggregate basis of $5.63x ($30x multiplied by $24x/$128x) and fair market value of $20x ($200x multiplied by $40x/$400x), resulting in aggregate gain in such portions of $14.38x (or $.48x gain in each such portion of the 30 shares). The portions attributable to the CFC2 stock have an aggregate basis of $13.13x ($30x multiplied by $56x/$128x) and fair market value of $80x ($200x multiplied by $160x/$400x), resulting in aggregate gain in such portions of $66.88x (or $2.23x in each such portion of the 30 shares). The portions attributable to Asset A have an aggregate basis of $11.25x ($30x multiplied by $48x/$128x) and fair market value of $100x ($200x multiplied by $200x/$400x), resulting in aggregate gain in such portions of $88.75x (or $2.96x in each such portion of the 30 shares). Thus, the aggregate gain in all the portions of the 30 shares is $170x ($14.38x plus $66.88x plus $88.75x).

(*2*) With respect to US2's 18 shares of FA stock, the portions attributable to the CFC1 stock have an aggregate basis of $3.38x ($18x multiplied by $24x/$128x) and fair market value of $12x ($120x multiplied by $40x/$400x), resulting in aggregate gain in such portions of $8.63x (or $.48x in each such portion of the 18 shares). The portions attributable to the CFC2 stock have an aggregate basis of $7.88x ($18x multiplied by $56x/$128x) and fair market value of $48x ($120x multiplied by $160x/$400x), resulting in aggregate gain of $40.13x (or $2.23x in each such portion of the 18 shares). The portions attributable to Asset A have an aggregate basis of $6.75x ($18x multiplied by $48x/$128x) and fair market value of $60x ($120x multiplied by $200x/$400x), resulting in aggregate gain of $53.25x (or $2.96x in each such portion of the 18 shares). Thus, the aggregate gain in all the portions of the 18 shares is $102x ($8.63x plus $40.13x plus $53.25x).

(*3*) Under §1.1248–8(b)(2)(iv), the earnings and profits of CFC1 attributable to the portions of US1's 30 shares of FA stock that relate to the CFC1 stock is $15x (the product of US1's 50% ownership interest percentage in UST multiplied by $30x of earnings and profits attributable to the CFC1 stock before the section 361 exchange, reduced by $0x of dividend included in UST's income with respect to the CFC1 stock under section 1248(a) attributable to US1). The earnings and profits of CFC2 attributable to the portions of US1's 30 shares of FA stock that relate to the CFC2 stock is $75x (the product of US1's 50% ownership interest percentage in UST multiplied by $150x of earnings and profits attributable

to the CFC2 stock before the section 361 exchange, reduced by $0x of dividend included in UST's income with respect to the CFC2 stock under section 1248(a) attributable to US1). Similarly, the earnings and profits of CFC1 attributable to the portions of US2's 18 shares of FA stock that relate to the CFC1 stock is $9x (the product of US2's 30% ownership interest percentage in UST multiplied by $30x of earnings and profits attributable to the CFC1 stock before the section 361 exchange, reduced by $0x of dividend included in UST's income with respect to the CFC1 stock under section 1248(a) attributable to US2). Finally, the earnings and profits of CFC2 attributable to the portions of US2's 18 shares of FA stock that relate to the CFC2 stock is $45x (the product of US2's 30% ownership interest percentage in UST multiplied by $150x of earnings and profits attributable to the CFC2 stock before the section 361 exchange, reduced by $0x of dividend included in UST's income with respect to the CFC2 stock under section 1248(a) attributable to US2).

(I) Under §1.1248(f)–2(c)(3), neither US1 nor US2 is required to reduce the aggregate section 358 basis in the portions of their respective shares of FA stock, and UST is not required to include in gross income any additional deemed dividend.

(*1*) US1 is not required to reduce the aggregate section 358 basis of the portions of its 30 shares of FA stock that relate to the CFC1 stock because the $10x section 1248(f) amount with respect to the CFC1 stock attributable to the portions of the shares of FA stock received by US1 (as computed in paragraph (ii)(G) of this *Example 3*) does not exceed US1's postdistribution amount (as defined in §1.1248(f)–1(c)(6), or $14.38x) in those portions. The $14.38x postdistribution amount equals the amount that US1 would be required to include in income as a dividend under section 1248(a) with respect to such portion if it sold the 30 shares of FA stock immediately after the distribution in a transaction in which all realized gain is recognized, without taking into account basis adjustments or income inclusions under §1.1248(f)–2(c)(3) ($20x fair market value, $5.63x basis, and $15x earnings and profits attributable to the portions for purposes of section 1248). Similarly, US1 is not required to reduce the aggregate section 358 basis of the portions of its 30 shares of FA stock that relate to the CFC2 stock because the $65x section 1248(f) amount with respect to the CFC2 stock attributable to the portions of the shares of FA stock received by US1 (as computed in paragraph (ii)(G) of this *Example 3*) does not exceed US1's postdistribution amount ($66.88x) in those portions. The $66.88x postdistribution amount equals the amount that US1 would be required to include in income as a dividend under section 1248(a) with respect to such portion if it sold the 30 shares of FA stock immediately after the distribution in a transaction in which all realized gain is recognized, without taking into account basis adjustments or income inclusions under §1.1248(f)–2(c)(3) ($80x fair market value, $13.13x basis, and $75x earnings and profits attributable to the portions for purposes of section 1248).

(*2*) US2 is not required to reduce the aggregate section 358 basis of the portions of its 18 shares of FA stock that relate to the CFC1 stock because the $6x section 1248(f) amount with respect to the CFC1 stock attributable to the portions of the shares of FA stock received by US2 (as computed in paragraph (ii)(G) of this *Example 3*) does not exceed US2's postdistribution amount ($8.63x) in those portions. The $8.63x postdistribution amount equals the amount that US2 would be required to include in income as a dividend under section 1248(a) with respect to such portion if it sold the 18 shares of FA stock immediately after the distribution in a transaction in which all realized gain is recognized, without taking into account basis adjustments or income inclusions under §1.1248(f)–2(c)(3) ($12x fair market value, $3.38x basis, and $9x earnings and profits attributable to the portions for purposes of section 1248). Similarly, US2 is not required to reduce the aggregate section 358 basis of the portions of its 18 shares of FA stock that relate to the CFC2 stock because the $39x section 1248(f) amount with respect to the CFC2 stock attributable to the portions of the shares of FA stock received by US2 (as computed in paragraph (ii)(G) of this *Example 3*) does not exceed US1's postdistribution amount ($40.13x) in those portions. The $40.13x postdistribution amount equals the amount that US2 would be required to include in income as a dividend under section 1248(a) with respect to such portion if it sold the 18 shares of FA stock immediately after the distribution in a transaction in which all realized gain is recognized, without taking into account basis adjustments or income inclusions under §1.1248(f)–2(c)(3) ($48x fair market value, $7.88x basis, and $45x earnings and profits attributable to the portions for purposes of section 1248).

(J) The amount of gain subject to the gain recognition agreement filed by each of US1 and US2 is determined pursuant to paragraph (e)(6)(i) of this section. The amount of gain subject to the gain recognition agreement filed by US1 with respect to the stock of CFC1 and CFC2 is $10x and $65x, respectively. The $10x and $65x are computed as the product of US1's ownership interest percentage (50%) multiplied by the gain realized by UST in the CFC1 stock ($20x) and CFC2 stock ($130x), respectively, as determined prior to taking into account the application of any other provision of section 367, reduced by the sum of the amounts described in paragraphs (e)(6)(i)(A) through (D) of this section with

respect to the CFC1 stock and CFC2 stock attributable to US1 ($0x with respect to the CFC1 stock, and $0x with respect to the CFC2 stock). The amount of gain subject to the gain recognition agreement filed by US2 with respect to the stock of CFC1 and CFC2 is $6x and $39x, respectively. The $6x and $39x are computed as the product of US2's ownership interest percentage (30%) multiplied by the gain realized by UST in the CFC1 stock ($20x) and CFC2 stock ($130x), respectively, as determined prior to taking into account the application of any other provision of section 367, reduced by the sum of the amounts described in paragraphs (e)(6)(i)(A) through (D) of this section with respect to the CFC1 stock and CFC2 stock attributable to US2 ($0x with respect to the CFC1 stock, and $0x with respect to the CFC2 stock). X is not required to enter into a gain recognition agreement because the amount of gain that would be subject to the gain recognition agreement is $0x with respect to the CFC1 stock, and $0x with respect to the CFC2 stock, computed as X's ownership percentage (20%) multiplied by the gain realized in the stock of CFC1 ($20x multiplied by 20%, or $4x) and CFC2 ($130x multiplied by 20%, or $26x), reduced by the amount of gain recognized by UST with respect to the stock of CFC1 and CFC2 that is attributable to X pursuant to §1.367(a)–7(c)(2) ($4x and $26x, respectively, as determined in paragraph (ii)(C) of this *Example 3*). Pursuant to paragraph (e)(6)(ii) of this section, each gain recognition agreement must include the election described in §1.367(a)–8(c)(2)(vi). Furthermore, pursuant to paragraph (e)(6)(iii) of this section, US1 and US2 must be designated as the U.S. transferor on their respective gain recognition agreements for purposes of §1.367(a)–8.

(9) *Illustration of rules.* For rules relating to certain distributions of stock of a foreign corporation by a domestic corporation, see section 1248(f) and §§1.1248(f)–1 through 1.1248(f)–3.

(f) *Failure to file statements*—(1) *Failure to file.* For purposes of the exceptions to the application of section 367(a)(1) provided in paragraphs (c) and (d)(2)(vi)(B) of this section, there is a failure to file a statement described in paragraph (c)(6), (c)(7), or (d)(2)(vi)(C) of this section (failure to file) if the statement is not filed with a timely filed U.S. income tax return or is not completed in all material respects.

(2) *Relief for certain failures to file that are not willful*—(i) *In general.* A failure to file described in paragraph (f)(1) of this section will be deemed not to have occurred for purposes of satisfying the requirements of the applicable regulation if the taxpayer demonstrates that the failure was not willful using the procedure set forth in this paragraph (f)(2). For this purpose, willful is to be interpreted consistent with the meaning of that term in the context of other civil penalties, which would include a failure due to gross negligence, reckless disregard, or willful neglect. Whether a failure to file was a willful failure will be determined by the Director of Field Operations International, Large Business & International (or any successor to the roles and responsibilities of such position, as appropriate) (Director) based on all the facts and circumstances. The taxpayer must submit a request for relief and an explanation as provided in paragraph (f)(2)(ii)(A) of this section. Although a taxpayer whose failure to file is determined not to be willful will not be subject to gain recognition under this section, the taxpayer will be subject to a penalty under section 6038B if the taxpayer fails to satisfy the reporting requirements, if any, under that section and does not demonstrate that the failure was due to reasonable cause and not willful neglect. See §1.6038B–1(b) and (f). The determination of whether the failure to file was willful under this section has no effect on any request for relief made under §1.6038B–1(f).

(ii) *Procedures for establishing that a failure to file was not willful*—(A) *Time and manner of submission.* A taxpayer's statement that the failure to file was not willful will be considered only if, promptly after the taxpayer becomes aware of the failure, an amended return is filed for the taxable year to which the failure relates that includes the information that should have been included with the original return for such taxable year or that otherwise complies with the rules of this section, and that includes a written statement explaining the reasons for the failure to file. The amended return must be filed with the Internal Revenue Service at the location where the taxpayer filed its original return. The taxpayer may submit a request for relief from the penalty under section 6038B as part of the same submission. See §1.6038B–1(f).

(B) *Notice requirement.* In addition to the requirements of paragraph

(f)(2)(ii)(A) of this section, the taxpayer must comply with the notice requirements of this paragraph (f)(2)(ii)(B). If any taxable year of the taxpayer is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Internal Revenue Service personnel conducting the examination. If no taxable year of the taxpayer is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Director.

(3) For illustrations of the application of the willfulness standard of this paragraph (f), see the examples in §1.367(a)–8(p)(3).

(g) *Effective/applicability dates*—(1) *Rules of applicability*. (i) Except as otherwise provided in this paragraph (g), the rules in paragraphs (a), (b), and (d) of this section apply to transfers occurring on or after July 20, 1998.

(ii) The following rules apply to transactions occurring on or after January 23, 2006—

(A) The rules in paragraphs (a) and (d) of this section, as they apply to section 368(a)(1)(A) reorganizations (including reorganizations described in section 368(a)(2)(D) or (E)) involving a foreign acquiring or foreign acquired corporation;

(B) The rules in paragraph (b)(2)(i)(B) of this section;

(C) The rules in paragraph (d) of this section, as they apply to section 368(a)(1)(G) reorganizations (including reorganizations described in section 368(a)(2)(D));

(D) The rules of paragraph (d)(1) and (d)(2)(iv), as they relate to exchanges by a U.S. person of securities of an acquired corporation for voting stock or securities of a foreign corporation in control of the acquiring corporation in a triangular section 368(a)(1)(B) reorganization;

(E) The rules in paragraph (d)(1) and (d)(2)(iv) of this section, as they relate to exchanges by a U.S. person of stock or securities of an acquired corporation for voting stock or securities of a domestic corporation in control of the foreign acquiring corporation in a triangular section 368(a)(1)(B) reorganization; and

(F) The rules in paragraph (d)(2)(vii) of this section.

(iii) The rules of paragraph (a) of this section that apply to transfers of securities in a section 354 or 356 exchange (pursuant to a section 368(a)(1)(E) reorganization or an asset reorganization that is not treated as an indirect stock transfer) that is not subject to section 367(a) apply only to transfers occurring after January 5, 2005 (although taxpayers may apply such provision to transfers of securities occurring on or after July 20, 1998, and on or before January 5, 2005, if done consistently to all transactions).

(iv) The rules in paragraph (d)(1)(v) of this section apply to:

(A) A reorganization described in section 368(a)(1)(C) followed by a controlled asset transfer if such reorganization occurs on or after July 20, 1998;

(B) A reorganization described in section 368(a)(1)(D) followed by a controlled asset transfer if such reorganization occurs after December 9, 2002 (for additional guidance concerning such reorganizations that occur on or after July 20, 1998 and on or before December 9, 2002, see Rev. Rul. 2002–85 (2002–2 C.B. 986) and §601.601(d)(2) of this chapter); and

(C) A reorganization described in section 368(a)(1)(A), (F), or (G) followed by a controlled asset transfer if such reorganization occurs on or after January 23, 2006.

(v) The rules of paragraph (d)(2)(vi) of this section apply only to transactions occurring on or after January 23, 2006. See §1.367(a)–3(d)(2)(vi), as contained in 26 CFR part 1 revised as of April 1, 2005, for transactions occurring on or after July 20, 1998 and before January 23, 2006.

(vi) With respect to certain transfers of domestic stock or securities, the rules in paragraph (c) of this section are generally applicable for transfers occurring after January 29, 1997. See §1.367(a)–3(c)(11). For transition rules regarding certain transfers of domestic stock or securities after December 16, 1987, and before January 30, 1997, and transfers of foreign stock or securities after December 16, 1987, and before July

20, 1998, see paragraph (j) of this section.

(vii)(A) Except as provided in this paragraph (g)(1)(vii), the rules of paragraph (e) of this section apply to transfers of stock or securities occurring on or after April 17, 2013. For matters covered in this section for periods before April 17, 2013, but on or after March 13, 2009, see §1.367(a)–3(e) as contained in 26 CFR part 1 revised as of April 1, 2012. For matters covered in this section for periods before March 13, 2009, but on or after March 7, 2007, see §1.367(a)–3T(e) as contained in 26 CFR part 1 revised as of April 1, 2007. For matters covered in this section for periods before March 7, 2007, but on or after July 20, 1998, see §1.367(a)–8(f)(2)(i) as contained in 26 CFR part 1 revised as of April 1, 2006.

(B) Taxpayers may apply the rules of §1.367(a)–3(e) to transfers occurring before March 13, 2009, and during a taxable year for which the period of limitations on assessments under section 6501(a) has not closed, if done consistently to all such transfers occurring during each taxable year. A taxpayer applies the rules of §1.367(a)–3(e) to transfers occurring before March 13, 2009, and during a taxable year for which the period of limitations on assessments under section 6501(a) has not closed, by including the gain recognition agreement, annual certification, or other information filing, that is required as a result of the rules of §1.367(a)–3(e) applying to such a transfer, with an amended tax return for the taxable year in which the transfer occurs that is filed on or before August 10, 2009. A taxpayer that wishes to apply the rules of §1.367(a)–3(e) to transfers occurring before March 13, 2009, and during a taxable year for which the period of limitations on assessments under section 6501(a) has not closed but that fails to meet the filing requirement described in the preceding sentence must request relief for reasonable cause for such failure as provided in §1.367(a)–8.

(viii) Paragraph (a)(2)(iv) of this section applies to exchanges occurring on or after May 17, 2011. For exchanges that occur prior to May 17, 2011, see §1.367(a)–3T(b)(2)(i)(C) as contained in 26 CFR part 1 revised as of April 1, 2011.

(ix) Paragraphs (d)(2)(vi)(B)(*1*)(*i*) and (*iii*), (d)(2)(vi)(B)(*2*), and (d)(3), *Examples 6B*, *6C*, and *9* of this section apply to transfers that occur on or after March 18, 2013. See paragraphs (d)(2)(vi)(B)(*1*)(*i*) and (*iii*), (d)(2)(vi)(B)(*2*), and (d)(3), *Examples 6B*, *6C*, and *9* of this section, as contained in 26 CFR part 1 revised as of April 1, 2012, for transfers that occur on or after January 23, 2006, and before March 18, 2013. Paragraph (d)(2)(vi)(B)(*1*)(*ii*) of this section applies to statements that are required to be filed on or after November 19, 2014. See paragraph (d)(2)(vi)(B)(*1*)(*ii*) of this section, as contained in 26 CFR part 1 revised as of April 1, 2014, for statements required to be filed on or after March 18, 2013, and before November 19, 2014.

(x) Paragraphs (c)(6)(ii) and (f) of this section apply to statements that are required to be filed on or after November 19, 2014, as well as to requests for relief submitted on or after November 19, 2014.

(2) *Election.* Notwithstanding paragraphs (g)(1) and (j) of this section, taxpayers may, by timely filing an original or amended return, elect to apply paragraphs (b) and (d) of this section to all transfers of foreign stock or securities occurring after December 16, 1987, and before July 20, 1998, except to the extent that a gain recognition agreement has been triggered prior to July 20, 1998. If an election is made under this paragraph (g)(2), the provisions of §1.367(a)–3T(g) (see 26 CFR part 1, revised April 1, 1998) shall apply, and, for this purpose, the term *substantial portion* under §1.367(a)–3T(g)(3)(iii) (see 26 CFR part 1, revised April 1, 1998) shall be interpreted to mean *substantially all* as defined in section 368(a)(1)(C). In addition, if such an election is made, the taxpayer must apply the rules under section 367(b) and the regulations thereunder to any transfers occurring within that period as if the election to apply §1.367(a)–3(b) and (d) to transfers occurring within that period had not been made, except that in the case of an exchange described in section 351 the taxpayer must apply section 367(b) and the regulations thereunder as if the exchange was described in §7.367(b)–7 of this chapter (as in effect before February 23, 2000; see 26 CFR

part 1, revised as of April 1, 1999). For example, if a U.S. person, pursuant to a section 351 exchange, transfers stock of a controlled foreign corporation in which it is a United States shareholder but does not receive back stock of a controlled foreign corporation in which it is a United States shareholder, the U.S. person must include in income under §7.367(b)–7 of this chapter (as in effect before February 23, 2000; see 26 CFR part 1, revised as of April 1, 1999) the section 1248 amount attributable to the stock exchanged (to the extent that the fair market value of the stock exchanged exceeds its adjusted basis). Such inclusion is required even though §7.367(b)–7 of this chapter (as in effect before February 23, 2000; see 26 CFR part 1, revised as of April 1, 1999), by its terms, did not apply to section 351 exchanges.

(h) *Former 10-year gain recognition agreements.* If a taxpayer elects to apply the rules of this section to all prior transfers occurring after December 16, 1987, any 10-year gain recognition agreement that remains in effect (has not been triggered in full) on July 20, 1998 will be considered by the Internal Revenue Service to be a 5-year gain recognition agreement with a duration of five full taxable years following the close of the taxable year of the initial transfer.

(i) [Reserved]

(j) *Transition rules regarding certain transfers of domestic or foreign stock or securities after December 16, 1987, and prior to July 20, 1998*—(1) *Scope.* Transfers of domestic stock or securities described under section 367(a) that occurred after December 16, 1987, and prior to April 17, 1994, and transfers of foreign stock or securities described under section 367(a) that occur after December 16, 1987, and prior to July 20, 1998 are subject to the rules contained in section 367(a) and the regulations thereunder, as modified by the rules contained in paragraph (j)(2) of this section. For transfers of domestic stock or securities described under section 367(a) that occurred after April 17, 1994 and before January 30, 1997, see Temporary Income Regulations under section 367(a) in effect at the time of the transfer (§1.367(a)–3T(a) and (c), 26 CFR part 1, revised April 1, 1996) and paragraph (c)(11) of this section. For transfers of domestic stock or securities described under section 367(a) that occur after January 29, 1997, see §1.367(a)–3(c).

(2) *Transfers of domestic or foreign stock or securities: Additional substantive rules*—(i) *Rule for less than 5-percent shareholders.* Unless paragraph (j)(2)(iii) of this section applies (in the case of domestic stock or securities) or paragraph (j)(2)(iv) of this section applies (in the case of foreign stock or securities), a U.S. transferor that transfers stock or securities of a domestic or foreign corporation in an exchange described in section 367(a) and owns less than 5 percent of both the total voting power and the total value of the stock of the transferee foreign corporation immediately after the transfer (taking into account the attribution rules of section 958) is not subject to section 367(a)(1) and is not required to enter into a gain recognition agreement.

(ii) *Rule for 5-percent shareholders.* Unless paragraph (j)(2)(iii) or (iv) of this section applies, a U.S. transferor that transfers domestic or foreign stock or securities in an exchange described in section 367(a) and owns at least 5 percent of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer (taking into account the attribution rules under section 958) may qualify for nonrecognition treatment by filing a gain recognition agreement in accordance with §1.367(a)–3T(g) in effect prior to July 20, 1998 (see 26 CFR part 1, revised April 1, 1998) for a duration of 5 or 10 years. The duration is 5 years if the U.S. transferor (5-percent shareholder) determines that all U.S. transferors, in the aggregate, own less than 50 percent of both the total voting power and the total value of the transferee foreign corporation immediately after the transfer. The duration is 10 years in all other cases. See, however, §1.367(a)–3(h). If a 5-percent shareholder fails to properly enter into a gain recognition agreement, the exchange is taxable to such shareholder under section 367(a)(1).

(iii) *Gain recognition agreement option not available to controlling U.S. transferor if U.S. stock or securities are transferred.* Notwithstanding the provisions of paragraph (j)(2)(ii) of this section, in no event will any exception to section 367(a)(1) apply to the transfer of stock or securities of a domestic corporation where the U.S. transferor owns (applying the attribution rules of section 958) more than 50 percent of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer (i.e., the use of a gain recognition agreement to qualify for nonrecognition treatment is unavailable in this case).

(iv) *Loss of United States shareholder status in the case of a transfer of foreign stock.* Notwithstanding the provisions of paragraphs (j)(2)(i) and (ii) of this section, in no event will any exception to section 367(a)(1) apply to the transfer of stock of a foreign corporation in which the U.S. transferor is a United States shareholder (as defined in §7.367(b)–2(b) of this chapter (as in effect before February 23, 2000; see 26 CFR part 1, revised as of April 1, 1999) or section 953(c)) unless the U.S. transferor receives back stock in a controlled foreign corporation (as defined in section 953(c), section 957(a) or section 957(b)) as to which the U.S. transferor is a United States shareholder immediately after the transfer.

(k) [Reserved] For further guidance, see §1.367–3T(k).

[T.D. 8702, 61 FR 68637, Dec. 30, 1996]

EDITORIAL NOTES: 1. For FEDERAL REGISTER citations affecting §1.367(a)–3, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at *www.fdsys.gov*.

2. By T.D. 9614, 78 FR 17031, Mar. 19, 2013, §1.367(a)–3 was amended by revising paragraphs (g)(1)(v)(A) and (B); however, these paragraphs did not exist and the amendment could not be incorporated into the section.

§1.367(a)–4 Special rules applicable to specified transfers of property.

(a) through (c)(2) [Reserved] For further guidance, see §1.367(a)–4T(a) through (c)(2).

(3) *Aircraft and vessels leased in foreign commerce.* For purposes of satisfying §1.367–4T(c)(1), aircraft or vessels, including component parts such as engines leased separately from aircraft or vessels, transferred to a foreign corporation and leased to other persons by the foreign corporation shall be considered to be transferred for use in the active conduct of a trade or business if—

(i) The employees of the foreign corporation perform substantial managerial and operational activities of leasing aircraft or vessels outside the United States; and

(ii) The leased tangible personal property is predominantly used outside the United States, as determined under §1.954–2(c)(2)(v).

(d) through (h) [Reserved] For further guidance, see §1.367–4T(d) through (h).

(i) *Effective/applicability date.* The rules of paragraph (c)(3) of this section apply for transfers of property occurring on or after May 2, 2006. Transferors may elect to apply these provisions to transfers occurring on or after October 22, 2004, by citing the provisions of paragraph (c)(3) of this section in the documentation for such transfers required by §1.6038B–1T(c)(4)(i) and (iv).

[T.D. 9525, 76 FR 26179, May 6, 2011]

§1.367(a)–4T Special rules applicable to specified transfers of property (temporary).

(a) *In general.* This section provides special rules for determining the applicability of section 367(a)(1) to specified transfers of property. Paragraph (b) of this section provides a special rule requiring the recapture of depreciation upon the transfer abroad of property previously used in the United States. Paragraphs (c) through (f) of this section provide rules for determining whether certain types of property are transferred for use in the active conduct of a trade or business outside of the United States. Paragraph (g) excepts certain transfers to FSCs from the operation of section 367(a)(1). The treatment of any transfer of property described in this section shall be determined exclusively under the rules of this section.

(b) *Depreciated property used in the U.S.*—(1) *In general.* If a U.S. person transfers U.S. depreciated property (as

defined in paragraph (b)(2) of this section) to a foreign corporation in an exchange described in section 367(a)(1), then that person shall include in its gross income for the taxable year in which the transfer occurs ordinary income equal to the gain realized that would have been includible in the transferor's gross income as ordinary income under section 617(d)(1), 1245(a), 1250(a), 1252(a), or 1254(a), whichever is applicable, if at the time of the transfer the transferor had sold the property at its fair market value. Recapture of depreciation under this paragraph (b) shall be required regardless of whether any exception to section 367(a)(1) (such as the exception for property transferred for use in the active conduct of a foreign trade or business) would otherwise apply to the transfer. However, any applicable exception shall apply with respect to realized gain that is not included in ordinary income pursuant to this paragraph (b).

(2) *U.S. depreciated property.* U.S. depreciated property subject to the rules of this paragraph (b) is any property that—

(i) Is either mining property (as defined in section 617(f)(2)), section 1245 property (as defined in section 1245(a)(3)), section 1250 property (as defined in section 1250(c)), farm land (as defined in section 1252(a)(2)), or oil, gas, or geothermal property (as defined in section 1254(a)(3)); and

(ii) Has been used in the United States or has qualified as section 38 property by virtue of section 48(a)(2)(B) prior to its transfer.

(3) *Property used within and without the U.S.* If U.S. depreciated property has been used partly within and partly without the United States, then the amount required to be included in ordinary income pursuant to this paragraph (b) shall be reduced to an amount determined in accordance with the following formula:

$$\text{Full recapture amount} \times \frac{\text{U.S. use}}{\text{Total use}}$$

For purposes of the above fraction, the *full recapture amount* is the amount that would otherwise be included in the transferor's income under paragraph (b)(1) of this section. *U.S. use* is the number of months that the property either was used within the United States or qualified as section 38 property by virtue of section 48(a)(2)(B), and was subject to depreciation by the transferor or a related person. *Total use* is the total number of months that the property was used (or available for use), and subject to depreciation, by the transferor or a related person. For purposes of this paragraph (b)(3), property shall not be considered to have been in use outside of the United States during any period in which such property was, for purposes of section 48 or 168, treated as property not used predominantly outside the United States pursuant to the provisions of section 48(a)(2)(B). For purposes of this paragraph (b)(3) the term *related person* shall have the meaning set forth in §1.367(d)–1T(h).

(4) [Reserved]

(5) *Effective date.* This paragraph (b) applies to transfers occurring on or after June 16, 1986.

(c) *Property to be leased*—(1) *Leasing business of transferee.* Tangible property transferred to a foreign corporation that will be leased to other persons by the foreign corporation shall be considered to be transferred for use in the active conduct of a trade or business outside of the United States only if—

(i) The transferee's leasing of the property constitutes the active conduct of a leasing business;

(ii) The lessee of the property is not expected to, and does not, use the property in the United States; and

(iii) The transferee has need for substantial investment in assets of the type transferred.

The active conduct of a leasing business requires that the employees of the foreign corporation perform substantial marketing, customer service, repair and maintenance, and other substantial operational activities with respect to the transferred property outside of the United States. Tangible property subject to the rules of this paragraph (c) includes real property located outside of the United States. The rules of §1.367(a)–5T(b) shall apply to transfers of property described in that section regardless of satisfaction of the rules of this paragraph (c).

(2) *De minimis leasing by transferee.* Tangible property transferred to a foreign corporation that will be leased to other persons by the foreign corporation and that does not satisfy the conditions of paragraph (b)(1) of this section shall, nevertheless, be considered to be transferred for use in the active conduct of a trade or business if either—

(i) The property transferred will be used by the transferee foreign corporation in the active conduct of a trade or business but will be leased during occasional brief periods when the property would otherwise be idle, such as an airplane leased during periods of excess capacity; or

(ii) The property transferred is real property located outside the United States and—

(A) The property will be used primarily in the active conduct of a trade or business of the transferee foreign corporation; and

(B) Not more than ten percent of the square footage of the property will be leased to others.

(3) [Reserved] For further guidance see §1.367(a)–4(c)(3).

(d) *Property to be sold.* Property shall not be considered to be transferred for use in the active conduct of a trade or business and a transfer of stock or securities shall not be excepted from section 367(a)(1) under the rules of §1.367(a)–3 if, at the time of the transfer, it is reasonable to believe that, in the reasonably foreseeable future, the transferee will sell or otherwise dispose of any material portion of the transferred stock, securities, or other property other than in the ordinary course of business.

(e) *Oil and gas working interests*—(1) *In general.* A working interest in oil and gas properties shall be considered to be transferred for use in the active conduct of a trade or business if—

(i) The transfer satisfies the conditions of paragraph (e)(2) of this section;

(ii) At the time of the transfer, the transferee has no intention to farmout or otherwise transfer any part of the transferred working interest; and

(iii) During the first three years after the transfer there are no farmouts or other transfers of any part of the transferred working interest as a result of which the transferee retains less than a 50 percent share of the transferred working interest.

(2) *Active use of working interest.* Working interests in oil and gas properties shall be considered to be transferred for use in the active conduct of a trade or business if—

(i) The transferor is regularly and substantially engaged in exploration for and extraction of minerals, either directly or through working interests in joint ventures, other than by reason of the property that is transferred;

(ii) The terms of the working interest transferred were actively negotiated among the joint venturers;

(iii) The working interest transferred constitutes at least a five percent working interest;

(iv) Prior to and at the time of the transfer, through its own employees or officers, the transferor was regularly and actively engaged in—

(A) Operating the working interest, or

(B) Analyzing technical data relating to the activities of the venture;

(v) Prior to and at the time of the transfer, through its own employees or officers, the transferor was regularly and actively involved in decision-making with respect to the operations of the venture, including decisions relating to exploration, development, production, and marketing; and

(vi) After the transfer, the transferee foreign corporation will for the foreseeable future satisfy the requirements of subdivisions (iv) and (v) of this paragraph (d)(2).

(3) *Start-up operations.* Working interests in oil and gas properties that do not satisfy the requirements of paragraph (e)(2) of this section shall, nevertheless, be considered to be transferred for use in the active conduct of a trade or business if—

(i) The working interest was acquired by the transferor immediately prior to the transfer and for the specific purpose of transferring it to the transferee foreign corporation;

(ii) The requirements of paragraph (e)(2)(ii) and (iii) of this section are satisfied; and

(iii) The transferee foreign corporation will for the foreseeable future satisfy the requirements of paragraph (e)(2)(iv) and (v) of this section.

(4) *Other applicable rules.* Oil and gas interests not described in this paragraph (e) may nonetheless qualify for the exception to section 367(a)(1) contained in §1.367(a)–2T, relating to transfers of property for use in the active conduct of a trade or business outside of the United States. However, a mere royalty interest in oil and gas properties will not be treated as transferred for use in the active conduct of a trade or business outside the United States. Moreover, a royalty or similar interest that constitutes intangible property will be subject to the rules of §1.367(d)–1T, relating to transfers of intangible property.

(f) *Compulsory transfers.* Property shall be presumed to be transferred for use in the active conduct of a trade or business outside of the United States, if—

(1) The property was previously in use in the country in which the transferee foreign corporation is organized; and

(2) The transfer is either:

(i) Legally required by the foreign government as a necessary condition of doing business in that country; or

(ii) Compelled by a genuine threat of immediate expropriation by the foreign government.

(g) *Relationship to other sections.* The rules of §§1.367(a)–5T, 1.367(a)–6T, and 1.367(d)–1T apply to transfers of property whether or not the property is transferred for use in the active conduct of a trade or business outside the United States. See §1.367(d)–1T(g)(2)(ii) for a special election with respect to compulsory transfers of intangible property.

(h) *Transfers of certain property to FSCs*—(1) *In general.* The provisions of section 367 (a) and (d) and the regulations thereunder shall not apply to a transfer of property by a U.S. person to a foreign corporation that constitutes a FSC, as defined in section 922(a), if—

(i) The transferee FSC uses the property to generate exempt foreign trade income, as defined in section 923(a);

(ii) The property is not excluded property, as defined in section 927(a)(2); and

(iii) The property consists of a corporate name or tangible property that is appropriate for use in the operation of a FSC office.

(2) *Exception.* The general rule in paragraph (g)(1) of this section shall not apply if, within three years after the original transfer, the original transferee FSC (or a subsequent transferee FSC) disposes of the property other than in the ordinary course of business or through a transfer to another FSC. Thus, the U.S. transferor may recognize gain in the taxable year in which the original transfer occurred through the application of section 367 and the regulations thereunder.

(i) [Reserved] For further guidance see §1.367(a)–4(i).

[T.D. 8087, 51 FR 17947, May 16, 1986, as amended by T.D. 8515, 59 FR 2960, Jan. 20, 1994; T.D. 9406, 73 FR 38116, July 3, 2008; T.D. 9525, 76 FR 26180, May 6, 2011; T.D. 9760, 81 FR 15169, Mar. 22, 2016]

§1.367(a)–5 Property subject to section 367(a)(1) regardless of use in a trade or business.

(a) through (f)(2) [Reserved] For further guidance, see §1.367(a)–5T(a) through (f)(2).

(3)(i) With respect to vessels and aircraft, including their component parts, that will be leased by the transferee to third persons, the transferee satisfies the conditions set forth in §1.367(a)–4(c)(3).

(ii) *Effective/applicability date.* The rules of this paragraph (f)(3) apply to transfers of property occurring on or after May 2, 2006. If the transferor makes the election to apply the provisions of §1.367(a)–4(c)(3) to transfers occurring on or after October 22, 2004, then paragraph (f)(3)(i) of this section will also apply to transfers affected by that election.

[T.D. 9525, 76 FR 26180, May 6, 2011]

§1.367(a)–5T Property subject to section 367(a)(1) regardless of use in trade or business (temporary).

(a) *In general.* Section 367(a)(1) shall apply to a transfer of property described in this section regardless of whether the property is transferred for

use in the active conduct of a trade or business. Certain exceptions to the operation of this rule are provided in this section, and a special gain limitation rule is provided in paragraph (e). A transfer of property described in this section is subject to section 367(a)(1) even if the transfer is a compulsory transfer described in §1.367(a)–4T(f).

(b) *Inventory, etc.* Regardless of use in an active trade or business, section 367(a)(1) shall apply to the transfer of—

(1) Stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business; and

(2) A copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by—

(i) A taxpayer whose personal efforts created such property;

(ii) In the case of a letter, memorandum, or similar property, a taxpayer from whom such property was prepared or produced; or

(iii) A taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or part by reference to the basis of such property in the hands of a taxpayer described in subdivision (i) or (ii) of this paragraph (b)(2).

For purposes of this section, the term *inventory* includes raw materials and supplies, partially completed goods, and finished products.

(c) *Installment obligations, etc.* Regardless of use in an active trade or business, section 367(a)(1) shall apply to the transfer of installment obligations, accounts receivable, or similar property, but only to the extent that the principal amount of any such obligation has not previously been included by the taxpayer in its taxable income.

(d) *Foreign currency, etc.*—(1) *In general.* Regardless of use in an active trade or business, section 367(a)(1) shall apply to the transfer of foreign currency or other property denominated in foreign currency, including installment obligations, futures contracts, forward contracts, accounts receivable, or any other obligation entitling its payee to receive payment in a currency other than U.S. dollars.

(2) *Exception for certain obligations.* If transferred property denominated in a foreign currency—

(i) Is denominated in the currency of the country in which the transferee foreign corporation is organized; and

(ii) Was acquired in the ordinary course of the business of the transferor that will be carried on by the transferee foreign corporation,

then section 367(a)(1) shall apply to the transfer only to the extent that gain is required to be recognized with respect to previously realized income reflected in installment obligations subject to paragraph (c) of this section. The rule of this paragraph (d)(2) shall not apply to transfers of foreign currency.

(3) *Limitation of gain required to be recognized.* If section 367(a)(1) applies to a transfer of property described in this paragraph, then the gain required to be recognized shall be limited to—

(i) The gain realized upon the transfer of property described in this paragraph (d), minus

(ii) Any loss realized as part of the same transaction upon the transfer of property described in this paragraph (d).

This limitation applies in lieu of the rule in §1.367(a)–1T(b)(1). No loss shall be recognized with respect to property described in this paragraph (d).

(e) *Intangible property.* Regardless of use in an active trade or business, a transfer of intangible property pursuant to section 332 shall be subject to section 367(a)(1), unless it constitutes foreign goodwill or going concern value, as defined in §1.367(a)–1T(d)(5)(iii). For rules concerning transfers of intangible property pursuant to section 351 or 361, see section 367(d) and §1.367(d)–1T.

(f) *Leased tangible property.* Regardless of use in an active trade or business, section 367(a)(1) shall apply to a transfer of tangible property with respect to which the transferor is a lessor at the time of the transfer, unless—

(1) With respect to property that will not be leased by the transferee to third persons, the transferee was the lessee of the property at the time of the transfer; or

(2) With respect to property that will be leased by the transferee to third persons, the transferee satisfies the conditions set forth in §1.367(a)–4T(c)(1) or (2).

(3) [Reserved] For further guidance see §1.367(a)–5(f)(3).

[T.D. 8087, 51 FR 17949, May 16, 1986, as amended by T.D. 9406, 73 FR 38116, July 3, 2008; T.D. 9525, 76 FR 26180, May 6, 2011]

§1.367(a)–6 Transfer of foreign branch with previously deducted losses.

(a) through (e)(3) [Reserved]. For further guidance, see §1.367(a)–6T(a) through (e)(3).

(4) *Gain recognized under section 367(a).* The previously deducted branch losses shall be reduced by any gain recognized pursuant to section 367(a)(1) (other than by reason of the provisions of this section) upon the transfer of the assets of the foreign branch to the foreign corporation. For transactions occurring on or after April 17, 2013, notwithstanding the prior sentence, this paragraph (e)(4) shall apply before the rules of §1.367(a)–7(c).

(e)(5) through (i) [Reserved]. For further guidance, see §1.367(a)–6T(e)(5) through (i).

[T.D. 9760, 81 FR 15169, Mar. 22, 2016]

§1.367(a)–6T Transfer of foreign branch with previously deducted losses (temporary).

(a) *In general.* This section provides special rules relating to the transfer of the assets of a foreign branch with previously deducted losses. Paragraph (b) of this section provides generally that such losses must be recaptured by the recognition of the gain realized on the transfer. Paragraph (c) of this section sets forth rules concerning the character of, and limitations on, the gain required to be recognized. Paragraph (d) of this section defines the term *previously deducted losses.* Paragraph (e) of this section describes certain reductions that are made to the previously deducted losses before they are taken into income under this section. Finally, paragraph (g) of this section defines the term *foreign branch.*

(b) *Recognition of gain required*—(1) *In general.* If a U.S. person transfers any assets of a foreign branch to a foreign corporation in an exchange described in section 367(a)(1), then the transferor shall recognize gain equal to—

(i) The sum of the previously deducted branch ordinary losses as defined and reduced in paragraphs (d) and (e) of this section; and

(ii) The sum of the previously deducted branch capital losses as defined and reduced in paragraphs (d) and (e) of this section.

(2) *No active conduct exception.* The rules of this paragraph (b) shall apply regardless of whether the assets of the foreign branch are transferred for use in the active conduct of a trade or business outside the United States.

(c) *Special rules concerning gain recognized*—(1) *Character and source of gain.* The gain described in paragraph (b)(1)(i) of this section shall be treated as ordinary income of the transferor, and the gain described in paragraph (b)(1)(ii) of this section shall be treated as long-term capital gain of the transferor. Gain that is recognized pursuant to the rules of this section shall be treated as income from sources outside the United States. Such recognized gain shall be treated as foreign oil and gas extraction income (as defined in section 907) in the same proportion that previously deducted foreign oil and gas extraction losses bore to the total amount of previously deducted losses.

(2) *Gain limitation.* For a rule limiting the amount of gain required to be recognized under section 367(a) upon any transfer of property to a foreign corporation, including the transfer of assets of a foreign branch with previously deducted losses, see §1.367(a)–1T(b)(3).

(3) *Foreign goodwill and going concern value.* For purposes of this section, the assets of a foreign branch shall include foreign goodwill and going concern value related to the business of the foreign branch, as defined in §1.367(a)–1T(d)(5)(iii). Thus, gain realized upon the transfer of the foreign goodwill or going concern value of a foreign branch to a foreign corporation will be taken into account in computing the limitation on loss recapture under paragraph (c)(2) of this section.

(4) *Transfers of certain intangible property.* Gain realized on the transfer of intangible property (computed with reference to the fair market value of the

intangible property as of the date of the transfer) that is an asset of a foreign branch shall be taken into account in computing the limitation on loss recapture under paragraph (c)(2) of this section. For rules relating to the crediting of gain recognized under this section against income deemed to arise by operation of section 367(d), see §1.367(d)–1T(g)(3).

(d) *Previously deducted losses*—(1) *In general.* This paragraph (d) provides rules for determining, for purposes of paragraph (b)(1) of this section, the previously deducted losses of a foreign branch any of whose assets are transferred to a foreign corporation in an exchange described in section 367(a)(1). Initially, the two previously deducted losses of a foreign branch for a taxable year are the total ordinary loss (''previously deducted branch ordinary loss'') and the total capital loss (''previously deducted branch capital loss'') that were realized by the foreign branch in that taxable year (a ''branch loss year'') prior to the transfer and that were or will be reflected on a U.S. income tax return of the transferor. The previously deducted branch ordinary loss for each branch loss year is reduced by expired net ordinary losses under paragraph (d)(2) of this section, while the previously deducted capital loss for each loss year is reduced by expired net capital losses under paragraph (d)(3) of this section. For each branch loss year, the remaining previously deducted branch ordinary loss and the remaining previously deducted branch capital loss are then reduced, proceeding from the first branch loss year to the last branch loss year, to reflect expired foreign tax credits under paragraph (d)(4) of this section. The reductions are made in the order of the taxable years in which the foreign tax credits arose. Finally, similar reductions are made to reflect expired investment credits under paragraph (d)(5) of this section.

(2) *Reduction by expired net ordinary loss*—(i) *In general.* The previously deducted branch ordinary loss for each branch loss year shall be reduced under this paragraph (d)(2) by the amount of any expired net ordinary loss with respect to that branch loss year. Expired net ordinary losses arising in years other than the branch loss year shall reduce the previously deducted branch ordinary loss for the branch loss year only to the extent that the previously deducted branch ordinary loss exceeds the net operating loss, if any, incurred by the transferor in the branch loss year. The previously deducted branch ordinary losses shall be reduced proceeding from the first branch loss year to the last branch loss year. For each branch loss year, expired net operating losses shall be applied to reduce the previously deducted branch ordinary loss for that year in the order in which the expired net ordinary losses arose.

(ii) *Existence of expired net ordinary loss.* An expired net ordinary loss exists with respect to a branch loss year to the extent that—

(A) The transferor incurred a net operating loss (within the meaning of section 172(c));

(B) That net operating loss arose in the branch loss year or was available for carryover or carryback to the branch loss year under section 172(b)(1);

(C) That net operating loss has neither given rise to a net operating loss deduction (within the meaning of section 172(a)) for any taxable year prior to the year of the transfer, nor given rise to a reduction of any previously deducted branch ordinary loss (pursuant to paragraph (d)(2) of this section) of any foreign branch of the transferor upon a previous transfer to a foreign corporation; and

(D) The period during which the transferor may claim a net operating loss deduction with respect to that net operating loss has expired.

(3) *Reduction by expired net capital loss*—(i) *In general.* The previously deducted branch capital loss for each branch loss year shall be reduced under this paragraph (d)(3) by the amount of any expired net capital loss with respect to that branch loss year. Expired net capital losses arising in years other than the branch loss year shall reduce the previously deducted branch capital loss for the branch loss year only to the extent that the previously deducted branch capital loss exceeds the net capital loss, if any, incurred by the transferor in the branch loss year. The previously deducted branch capital losses shall be reduced proceeding from

the first branch loss year to the last branch loss year. For each branch loss year, expired net capital losses shall be applied to reduce the previously deducted branch capital loss for that year in the order in which the expired net capital losses arose.

(ii) *Existence of expired net capital loss.* An expired net capital loss exists with respect to a branch loss year to the extent that—

(A) The transferor incurred a net capital loss (within the meaning of section 1222(10));

(B) That net capital loss arose in the branch loss year or was available for carryover or carryback to the branch loss year under section 1212;

(C) That net capital loss has neither been allowed for any taxable year prior to the year of the transfer, nor given rise to a reduction of any previously deducted branch capital loss (pursuant to paragraph (c)(3) of this section) of any foreign branch of the transferor upon any previous transfer to a foreign corporation; and

(D) The period during which the transferor may claim a capital loss deduction with respect to that net capital loss has expired.

(4) *Reduction for expired foreign tax credit*—(i) *In general.* The previously deducted branch ordinary loss and the previously deducted branch capital loss for each branch loss year remaining after the reductions described in paragraph (d)(2) and (3) of this section shall be further reduced under this paragraph (d)(4) proportionately by the amount of any expired foreign tax credit loss equivalent with respect to that branch loss year. The previously deducted branch losses shall be reduced proceeding from the first branch loss year to the last branch loss year. For each branch loss year, expired foreign tax credit loss equivalents shall be applied to reduce the previously deducted branch loss for that year in the order in which the expired foreign tax credits arose.

(ii) *Existence of foreign tax credit loss equivalent.* A foreign tax credit loss equivalent exists with respect to a branch loss year if—

(A) The transferor paid, accrued, or is deemed under section 902 or 960 to have paid creditable foreign taxes in a taxable year;

(B) The creditable foreign taxes were paid, accrued, or deemed paid in the branch loss year or were available for carryover or carryback to the branch loss year under section 904(c);

(C) No foreign tax credit with respect to the foreign taxes paid, accrued, or deemed paid has been taken because of the operation of section 904(a) or similar limitations provided by the Code or an applicable treaty, and such taxes have not given rise to a reduction (pursuant to this paragraph (d)(5)) of any previously deducted branch loss of the foreign branch for a prior taxable year or of any previously deducted branch losses of any foreign branch of the transferor upon a prior transfer to a foreign corporation; and

(D) The period during which the transferor may claim a foreign tax credit for the foreign taxes paid, accrued, or deemed paid has expired.

(iii) *Amount of foreign tax credit loss equivalent.* The amount of the foreign tax credit loss equivalent for the branch loss year with respect to the creditable foreign taxes described in paragraph (d)(4)(ii) of this section is the amount of those creditable foreign taxes divided by the highest rate of tax to which the transferor was subject in the loss year.

(5) *Reduction for expired investment credits*—(i) *In general.* The previously deducted branch ordinary loss and the previously deducted branch capital loss for each branch loss year shall be further reduced under this paragraph (d)(5) proportionately by the amount of any expired investment credit loss equivalent with respect to that branch year. The previously deducted branch losses shall be reduced proceeding from the first branch loss year to the last branch loss year. For each branch loss year, expired investment credit loss equivalents shall be applied to reduce the previously deducted branch loss for that year in the order in which the expired investment credits were earned.

(ii) *Existence of investment credit loss equivalent.* An investment credit loss equivalent exists with respect to a branch loss year if—

(A) The transferor earned an investment credit (within the meaning of section 46(a)) in a taxable year;

(B) The investment credit was earned in the branch loss year or was available for carryover or carryback to the branch loss year under section 39;

(C) The investment credit earned by the transferor in the credit year has been denied by section 38(a) or by similar provisions of the Code and has not given rise to a reduction (pursuant to this paragraph (d)(5)) of any previously deducted branch loss of the foreign branch for a preceding taxable year or of the previously deducted losses of any foreign branch of the transferor upon any previous transfer to a foreign corporation; and

(D) The period during which the transferor may claim the investment credit has expired.

(iii) *Amount of investment tax credit loss equivalent.* The amount of the investment credit loss equivalent for the branch loss year with respect to the investment credit described in paragraph (d)(5)(ii) of this section is 85 percent of the amount of that investment credit divided by the highest rate of tax to which the transferor was subject in the loss year.

(e) *Amounts that reduce previously deducted losses subject to recapture*—(1) *In general.* This paragraph (e) describes five amounts that reduce the sum of the previously deducted branch ordinary losses and the sum of the previously deducted branch capital losses before they are taken into income under paragraph (b) of this section. Amounts representing ordinary income shall be applied to reduce first the sum of the previously deducted branch ordinary losses to the extent thereof, and then the sum of the previously deducted branch capital losses to the extent thereof. Similarly, amounts representing capital gains shall be applied to reduce first the sum of the previously deducted branch capital losses and then the sum of the previously deducted branch ordinary losses.

(2) *Taxable income.* The previously deducted losses shall be reduced by any taxable income of the foreign branch recognized through the close of the taxable year of the transfer, whether before or after any taxable year in which losses were incurred.

(3) *Amounts currently recaptured under section 904(f)(3).* The previously deducted losses shall be reduced by the amount recognized under section 904(f)(3) on account of the transfer.

(4) [Reserved]

(5) *Amounts previously recaptured under section 904(f)(3)*—(i) *In general.* The previously deducted branch losses shall be reduced by the portion of any amount recognized under section 904(f)(3) upon a previous transfer of property that was attributable to the losses of the foreign branch, provided that the amount did not reduce any gain otherwise required to be recognized under section 367(a)(3)(C) and this section (or Revenue Ruling 78–201, 1978–1 C.B. 91).

(ii) *Portion attributable to the losses of the foreign branch*—(A) *Branch property.* The full amount recognized under section 904(f)(3) upon a previous transfer of property of the branch shall be treated as attributable to the losses of the foreign branch.

(B) *Non-branch property.* The portion of the amount previously recognized under section 904(f)(3) upon a transfer of non-branch property that was attributable to the losses of the foreign branch shall be the sum, over the taxable years in which the transferor sustained an overall foreign loss some portion of which was recaptured on the disposition, of the recaptured portions of those overall foreign losses after multiplication by the following fraction:

$$\frac{\text{Losses of the foreign branch for the year}}{\text{All foreign losses for the year}}$$

For purposes of this fraction, the term *losses of the foreign branch for the year* means the losses of the foreign branch that were taken into account under section 904(f)(2) in determining the amount of the transferor's overall foreign loss for the year, and the term *all foreign losses for the year* means all of the losses of the transferor that were taken into account under section 904(f)(2).

(6) *Amounts previously recognized under the rules of this section.* The previously deducted losses shall be reduced by the amounts previously recognized under the rules of this section upon a previous transfer of assets of the foreign branch.

(f) *Example.* The rules of paragraphs (b) through (e) of this section are illustrated by the following example.

Example. (i) *Facts.* X, a U.S. corporation, is a calendar year taxpayer. On January 1, 1981, X established a branch in foreign country A to manufacture and sell X's products in country A. On July 1, 1986, X organized corporation Y, a country A subsidiary, and transferred to Y all of the assets of its country A branch, including goodwill and going concern value. During the period from January 1, 1981, through July 1, 1986, X's country A branch earned income and incurred losses in the following amounts:

COUNTRY A BRANCH

Year	Ordinary income (loss)	Capital gain (loss)
1981	(200)	0
1982	(300)	(100)
1983	(400)	0
1984	(200)	0
1985	(100)	0
1986	50	0

At the time of the transfer of X's country A branch assets to Y, those assets had a fair market value of $2,500 and an adjusted basis of $1,000. For each of the assets, fair market value exceeded adjusted basis. X had no net capital loss or unused investment credit during any taxable year relevant to the transfer. In 1984, X incurred a net operating loss of $400, $200 of which was carried back to prior years. An additional $50 of the 1984 net operating loss was carried over to 1985. The remaining $150 of the 1984 net operating loss was not used in any year prior to the transfer. In 1979, X paid creditable foreign taxes of $330 that could not be claimed as a credit in that year or any earlier year because of section 904. Of those foreign taxes, $100 were carried over and claimed as a credit in 1983, but the remaining $230 were not used in any year prior to the transfer. X was not required to recognize any gain under section 904(f)(3) on account of the 1986 transfer or any prior transfer. X was not required to recognize gain upon the transfer under section 367(a) (other than by reason of the provisions of this section).

(ii) *Previously deducted losses.* The previously deducted losses of X's country A branch are $575 of ordinary losses and $25 of capital losses, computed as follows: Initially, the branch has previously deducted ordinary losses of $1,000 ($200 + $300 + $400 + $100), and previously deducted capital losses of $100. (See paragraph (d)(1) of this section.)

(iii) *Expired losses and credits.* Under the facts of this example, there are no reductions for expired net ordinary losses or expired net capital losses under paragraph (d)(2) or (3) of this section. However, the previously deducted losses are reduced proceeding from the first branch loss year to the last branch loss year to reflect the expired foreign tax credit from 1979. The amount of the foreign tax credit loss equivalent with respect to 1981 is $500 ($230/.46). It reduces the previously deducted losses for 1981 proportionately. Thus, the previously deducted ordinary loss for 1981 is reduced from $200 to $0. (See paragraph (d)(4) of this section.) The amount of the foreign tax credit loss equivalent with respect to 1982 is $300 ($500 − $200, *i.e.*, $138/.46). (See paragraph (d)(4)(ii)(C) of this section.) It reduces the previously deducted losses for 1982 proportionately. Thus, the previously deducted ordinary loss for 1982 is reduced from $300 to $75, and the previously deducted capital loss for 1982 is reduced from $100 to $25.

(iv) *Further reductions.* The previously deducted ordinary losses of $575 and the previously deducted capital losses of $25 are reduced by the taxable income earned by the branch prior to the date of the transfer ($250). (See paragraph (e)(2) of this section.) Since that income was ordinary income, it is applied first to reduce the previously deducted ordinary losses of $575 to $325. (See paragraph (e)(1) of this section.)

(v) *Recapture.* Since the gain realized by X upon its transfer of the branch assets to Y exceeds the sum of the previously deducted branch losses as defined and reduced above ($325 + $25), the limitation in paragraph (c)(2) of this section does not apply. Thus, X is required to recognize $325 of ordinary income and $25 of long-term capital gain upon the transfer. (See paragraph (b) and (c)(1) of this section.)

(g) *Definition of foreign branch*—(1) *In general.* For purposes of this section, the term *foreign branch* means an integral business operation carried on by a U.S. person outside the United States. Whether the activities of a U.S. person

outside the United States constitute a foreign branch operation must be determined under all the facts and circumstances. Evidence of the existence of a foreign branch includes, but is not limited to, the existence of a separate set of books and records, and the existence of an office or other fixed place of business used by employees or officers of the U.S. person in carrying out business activities outside the United States. Activities outside the United States shall be deemed to constitute a foreign branch for purposes of this section if the activities constitute a permanent establishment under the terms of a treaty between the United States and the country in which the activities are carried out. Any U.S. person may be treated as having a foreign branch for purposes of this section, whether that person is a corporation, partnership, trust, estate, or individual.

(2) *More than one branch.* If a U.S. person carries on more than one branch operation outside the United States, then the rules of this section must be separately applied with respect to each foreign branch that is transferred to a foreign corporation. Thus, the previously deducted losses of one branch may not be offset, for purposes of determining the gain required to be recognized under the rules of this section, by the income of another branch that is also transferred to a foreign corporation. Similarly, the losses of one branch shall not be recaptured upon a transfer of the assets of a separate branch. Whether the foreign activities of a U.S. person are carried out through more than one branch must be determined under all of the facts and circumstances. In general, a separate branch exists if a particular group of activities is sufficiently integrated to constitute a single business that could be operated as an independent enterprise. For purposes of determining the combination of activities that constitute a branch operation as defined in this paragraph (g), the nominal relationship among those activities shall not be controlling. Factors suggesting that nominally separate business operations constitute a single foreign branch include a substantial identity of products, customers, operational facilities, operational processes, accounting and record-keeping functions, management, employees, distribution channels, or sales and purchasing forces. For examples of the application of the principles of this paragraph (g)(2), see Revenue Ruling 81–82, 1981–1 C.B. 127.

(3) *Consolidated group.* For purposes of this section, the activities of each of two domestic corporations outside the United States will be considered to constitute a single foreign branch if—

(i) The two corporations are members of the same consolidated group of corporations; and

(ii) The activities of the two corporations in the aggregate would constitute a single foreign branch if conducted by a single corporation.

Notwithstanding the preceding rule of this paragraph (g)(3), gains of a foreign branch of a domestic corporation arising in a year in which that corporation did not file a consolidated return with a second domestic corporation shall not be applied to reduce the previously deducted losses of a foreign branch of the second corporation (but may be applied to reduce such losses of the foreign branch of the first corporation) upon the transfer of the two branches to a foreign corporation, even though the two domestic corporations file a consolidated return for the year in which the transfer occurs and the two branches are considered at that time to constitute a single foreign branch. For an example of the application of the principles of this paragraph (g)(3), see Revenue Ruling 81–89, 1981–1 C.B. 129.

(4) *Property not transferred.* A U.S. transferor's failure to transfer any property of a foreign branch shall be irrelevant to the determination of the previously deducted losses of the branch subject to recapture under the rules of this section. Thus, if the activities with respect to untransferred property constituted a part of the branch operation under the rules of this paragraph (g), then the losses generated by those activities shall be subject to recapture, notwithstanding the failure to transfer the property. For an example of the application of the principles of this paragraph (g)(4), see Revenue Ruling 80–247, 1980–2 C.B. 127, relating to property abandoned by the U.S. transferor.

(h) *Anti-abuse rule.* If—

(1) A U.S. person transfers property of a foreign branch to a domestic corporation for a principal purpose of avoiding the effect of this section; and

(2) The domestic corporation thereafter transfers the property of the foreign branch to a foreign corporation,

Then, solely for purposes of this section, that U.S. person shall be treated as having transferred the property of the branch directly to the foreign corporation. A U.S. person shall be presumed to have transferred property of a foreign branch for a principal purpose of avoiding the effect of this section if the property is transferred to the domestic corporation less than two years prior to the domestic corporation's transfer of the property to a foreign corporation. This presumption may be rebutted by clear evidence that the subsequent transfer of the property was not contemplated at the time of the initial transfer to the domestic corporation and that avoidance of the effect of this section was not a principal purpose for the transaction. A transfer may have more than one principal purpose.

(i) *Basis adjustments.* Basis adjustments reflecting gain recognized pursuant to this section shall be made as described in §1.367(a)–1T(b)(4)(ii).

[T.D. 8087, 51 FR 17950, May 16, 1986, as amended by T.D. 9615, 78 FR 17063, Mar. 19, 2013; T.D. 9760, 81 FR 15169, Mar. 22, 2016]

§1.367(a)–7 Outbound transfers of property described in section 361(a) or (b).

(a) *Scope and purpose.* This section provides rules under section 367(a)(5) that apply to the transfer of certain property (including stock or securities) by a domestic corporation (U.S. transferor) to a foreign corporation (foreign acquiring corporation) in a section 361 exchange. This section applies only to the transfer of section 367(a) property. See section 367(d) for rules applicable to transfers of section 367(d) property. Paragraph (b) of this section provides the general rule requiring the recognition of gain on the transfer of section 367(a) property, while paragraph (c) of this section provides an elective exception to the general rule that is available if certain requirements are satisfied. Paragraph (d) of this section provides rules for applying the elective exception to a section 361 exchange followed by successive distributions to which section 355 applies. Paragraph (e) of this section provides rules for recognizing gain on section 367(a) property, not willful relief provisions, an anti-abuse rule, and special rules that take into account income inclusions under §1.367(b)–4 and gain recognition under §1.367(a)–6T. Paragraph (f) of this section provides definitions, and paragraph (g) of this section provides examples. Paragraph (h) of this section provides applicable cross-references, paragraph (i) of this section is reserved, and paragraph (j) of this section provides effective/applicability dates.

(b) *General rule*—(1) *Nonrecognition exchanges enumerated in section 367(a)(1).* Except to the extent provided in paragraphs (b)(2) and (c) of this section, the exceptions to section 367(a)(1) provided in section 367(a) and the regulations under that section do not apply to a transfer of section 367(a) property by a U.S. transferor to a foreign acquiring corporation in a section 361 exchange, and the U.S. transferor shall recognize any gain (but not loss) realized with respect to the section 367(a) property under section 367(a)(1). Realized gain is recognized pursuant to the prior sentence notwithstanding the application of any other nonrecognition provision enumerated in section 367(a)(1) to the transfer (such as section 351 or 354).

(2) *Nonrecognition exchanges not enumerated in section 367(a)(1).* To the extent a transfer of items of property described in paragraph (b)(1) of this section also qualifies for nonrecognition under a provision that is not enumerated in section 367(a)(1) (such as section 1036), the U.S. transferor recognizes gain or loss realized on the transfer of such items of property, but the amount of loss recognized on the property shall not exceed the amount of gain recognized on the property. See section 337(d).

(c) *Elective exception.* Except to the extent provided in paragraph (d) of this section, paragraph (b) of this section does not apply to the transfer of section 367(a) property by a U.S. transferor to a foreign acquiring corporation in a section 361 exchange if the conditions of paragraphs (c)(1), (c)(2), (c)(3),

and (c)(4) of this section are satisfied, and an election to apply the exception provided by this paragraph (c) is made in the manner provided by paragraph (c)(5) of this section. If this paragraph (c) applies to the section 361 exchange, see, for example, §§1.367(a)–2T, 1.367(a)–3, 1.367(a)–4T, 1.367(a)–5T, or 1.367(a)–6T, as applicable, for additional requirements that must be satisfied in order for the U.S. transferor to not recognize gain under section 367(a)(1) on the transfer of section 367(a) property in the section 361 exchange. Nothing in this section provides for the nonrecognition of gain not otherwise permitted under another provision of the Internal Revenue Code (Code) or the regulations.

(1) *Control.* Immediately before the reorganization, the U.S. transferor is controlled (within the meaning of section 368(c)) by five or fewer, but at least one, control group members. For illustrations of this rule, see paragraph (g) of this section, *Example 4* and *Example 5*.

(2) *Gain recognition*—(i) *Non-control group members.* The U.S. transferor recognizes gain equal to the product of the inside gain multiplied by the aggregate ownership interest percentage of all non-control group members, reduced (but not below zero) by the sum of the amounts described in paragraphs (c)(2)(i)(A), (c)(2)(i)(B), and (c)(2)(i)(C) of this section.

(A) Gain recognized with respect to stock or securities under §1.367(a)–3(e)(3)(iii)(B) (including any portion treated as a deemed dividend under section 1248(a));

(B) Gain recognized with respect to stock or securities under §1.367(a)–6T (including any portion treated as a deemed dividend under section 1248(a)) attributable to non-control group members (as determined pursuant to §1.367(a)–7(e)(5)); and

(C) A deemed dividend included in income under §1.367(b)–4 attributable to non-control group members (as determined pursuant to §1.367(a)–7(e)(4)).

(ii) *Control group members.* With respect to each control group member, the U.S. transferor recognizes gain equal to the amount, if any, by which the amount described in paragraph (c)(2)(ii)(A) of this section exceeds the amount described in paragraph (c)(2)(ii)(B) of this section.

(A) The product of the inside gain multiplied by such control group member's ownership interest percentage, reduced (but not below zero) by the sum of the amounts described in paragraphs (c)(2)(ii)(A)(*1*), (c)(2)(ii)(A)(*2*), and (c)(2)(ii)(A)(*3*) of this section (attributable inside gain).

(*1*) Gain recognized with respect to stock or securities under §1.367(a)–3(e)(3)(iii)(C) (including any portion treated as a deemed dividend under section 1248(a)) attributable to the control group member;

(*2*) Gain recognized with respect to stock or securities under §1.367(a)–6T (including any portion treated as a deemed dividend under section 1248(a)) attributable to the control group member (as determined pursuant to §1.367(a)–7(e)(5)); and

(*3*) A deemed dividend included in income under §1.367(b)–4 attributable to the control group member (as determined pursuant to §1.367(a)–7(e)(4)).

(B) The product of the section 367(a) percentage multiplied by the fair market value of the stock received by the U.S. transferor in the section 361 exchange and distributed to the control group member under section 354, 355, or 356.

(iii) *Illustration of rules.* For an illustration of gain recognition under paragraph (c)(2)(i) of this section, see paragraph (g) of this section, *Example 1*. For an illustration of gain recognition under paragraph (c)(2)(ii) of this section, see paragraph (g) of this section, *Example 2*.

(3) *Basis adjustments required for control group members*—(i) *General rule.* Except as provided in paragraph (c)(3)(iv) of this section, if there is any attributable inside gain (determined under paragraph (c)(2)(ii)(A) of this section) with respect to a control group member, then such control group member's aggregate basis in the stock received in exchange for (or with respect to, as applicable) stock or securities of the U.S. transferor under section 354, 355, or 356, as determined under section 358 and the regulations under that section (section 358 basis), is reduced by the amount in paragraph (c)(3)(i)(A),

(c)(3)(i)(B), or (c)(3)(i)(C) of this section, as applicable.

(A) If the control group member has outside gain, the amount, if any, by which the attributable inside gain, reduced by any gain recognized by the U.S. transferor with respect to the control group member under paragraph (c)(2)(ii) of this section, exceeds the control group member's outside gain.

(B) If the control group member has outside loss, the amount, if any, by which the attributable inside gain, reduced by any gain recognized by the U.S. transferor with respect to the control group member under paragraph (c)(2)(ii) of this section, exceeds the control group member's outside loss (for this purpose, treating the outside loss as a negative amount).

(C) If the control group member has no outside gain or outside loss, the amount of the attributable inside gain, reduced by any gain recognized by the U.S. transferor with respect to the control group member under paragraph (c)(2)(ii) of this section.

(ii) *Stock received in the section 361 exchange.* This paragraph (c)(3) applies only to stock received by the U.S. transferor in the section 361 exchange and distributed to the control group member in exchange for (or with respect to, as applicable) stock or securities of the U.S. transferor.

(iii) *Pro rata adjustments.* The section 358 basis of each share of stock received by the control group member must be reduced pro rata based on the relative section 358 basis of all shares of stock received by the control group member.

(iv) *Successive distributions to which section 355 applies.* Paragraph (c)(3) of this section does not apply to a control group member that distributes the stock of a foreign acquiring corporation received from the U.S. transferor in a distribution satisfying the requirements of section 355 (section 355 distribution) that is in connection with a transaction described in paragraph (d) of this section (relating to successive section 355 distributions). If paragraph (c)(3) of this section does not apply to a control group member pursuant to this paragraph (c)(3)(iv), then paragraph (c)(3) of this section shall apply to the final distributee (as defined in paragraph (d) of this section) that receives the stock of the foreign acquiring corporation in the final section 355 distribution described in paragraph (d) of this section.

(v) *Illustration of rules.* For illustrations of the adjustment to stock basis under paragraph (c)(3)(i) of this section, see paragraph (g) of this section, *Example 1* and *Example 2*, §1.367(a)–3(e)(8), *Example 3*, and §1.1248(f)–2(e), *Example 3*. For an illustration of the adjustment to stock basis under paragraph (c)(3)(iii) of this section, see paragraph (g) of this section, *Example 3*.

(4) *Agreement to amend or file a U.S. income tax return*—(i) *General rule.* Except as provided in paragraph (c)(4)(ii) of this section, the U.S. transferor complies with the requirements of §1.6038B–1(c)(6)(iii), relating to the requirement to report gain that was not recognized by the U.S. transferor upon certain subsequent dispositions by the foreign acquiring corporation of section 367(a) property received from the U.S. transferor in the section 361 exchange.

(ii) *Exception.* To the extent section 367(a) property transferred in the section 361 exchange is subject to §1.367(a)–3(e) (relating to transfers of stock or securities by a domestic corporation to a foreign corporation in a section 361 exchange), §1.6038B–1(c)(6)(iii) does not apply with respect to the transfer of that property.

(5) *Election and reporting requirements*—(i) *General rule.* The U.S. transferor and each control group member elect to apply the provisions of paragraph (c) of this section in the manner provided under paragraph (c)(5)(ii) or (c)(5)(iii) of this section, as applicable, and by entering into a written agreement described in paragraph (c)(5)(iv) of this section. If a control group member distributes the stock of the foreign acquiring corporation received from the U.S. transferor in a section 355 distribution that is in connection with a transaction described in paragraph (d) of this section, the final distributee that receives that stock in the final section 355 distribution elects to apply the provisions of this paragraph (c) and enters into the written agreement instead of the control group member. For this purpose, the term *control group*

member will be replaced by the term *final distributee*, as appropriate.

(ii) *Control group member*—(A) *Time and manner of making election.* Each control group member elects to apply the provisions of paragraph (c) of this section by including a statement (in the form and with the content specified in paragraph (c)(5)(ii)(B) of this section) on or with a timely filed return for the taxable year in which the reorganization occurs. If the control group member is a member of a consolidated group but is not the common parent of the consolidated group, the common parent makes the election on behalf of the control group member.

(B) *Form and content of election statement.* The statement must be entitled, ''ELECTION TO APPLY EXCEPTION UNDER §1.367(a)–7(c),'' and set forth:

(*1*) The name and taxpayer identification number (if any) of the control group member, the U.S. transferor, the foreign acquiring corporation and, in the case of a triangular reorganization (within the meaning of §1.358–6(b)(2)), the corporation that controls the foreign acquiring corporation; the control group member's ownership interest percentage in the U.S. transferor; and the percentage of voting stock and non-voting stock of the U.S. transferor owned by the control group member for purposes of satisfying the control requirement of paragraph (c)(1) of this section;

(*2*) If the control group member is a member of a consolidated group but is not the common parent, the name and taxpayer identification number of the common parent;

(*3*) The amount of the adjustment (if any) to stock basis required under paragraph (c)(3) of this section, the resulting adjusted basis in the stock, and the fair market value of the stock, or if no stock was received, indicate no stock was received; and

(*4*) The date on which the written agreement described in paragraph (c)(5)(iv) of this section was entered into.

(iii) *Statement by U.S. transferor.* The U.S. transferor elects to apply the provisions of paragraph (c) of this section in the form and manner set forth in §1.6038B–1(c)(6)(ii).

(iv) *Written agreement.* The U.S. transferor and each control group member must enter into a written agreement satisfying the conditions of this paragraph on or before the due date (including extensions) for the U.S. transferor's tax return for the taxable year in which the reorganization occurs. Each party to the agreement must retain the original or a copy of the agreement in the manner specified by §1.6001–1(e). Each party to the agreement must provide a copy of the agreement to the Internal Revenue Service within 30 days of the receipt of a request for the copy of the agreement. The written agreement must—

(A) State the document constitutes an agreement entered into pursuant to paragraph (c)(5) of this section;

(B) Identify the U.S. transferor, the foreign acquiring corporation, the corporation that controls the foreign acquiring corporation (in the case of a triangular reorganization within the meaning of §1.358–6(b)(2)), and each control group member, and provide the taxpayer identification number (if any) for each corporation;

(C) State the amount of gain (if any) recognized by the U.S. transferor under paragraph (c)(2) of this section; and

(D) With respect to each control group member, state the amount of the adjustment (if any) to stock basis required under paragraph (c)(3) of this section, the resulting adjusted basis in the stock, and the fair market value of the stock. Alternatively, if a control group member did not receive any stock, indicate that no stock was received.

(d) *Section 361 exchange followed by successive distributions to which section 355 applies.* If the U.S. transferor distributes stock of the foreign acquiring corporation received in the section 361 exchange to a control group member in a section 355 distribution and, as part of a plan or series of related transactions, that stock is further distributed in one or more successive section 355 distributions, paragraph (c) of this section can apply to the section 361 exchange only to the extent each subsequent section 355 distribution is to a member of the affiliated group (within the meaning of section 1504) that includes the U.S. transferor immediately

before the reorganization. In that case, each affiliated group member that receives stock of the foreign acquiring corporation in the final section 355 distribution (final distributee) is subject to the requirements of paragraphs (c)(3) and (c)(5) of this section. If this paragraph (d) applies, then for purposes of applying paragraphs (c)(3), (c)(5) or (e)(2) of this section the term *control group member* is replaced by the term *final distributee,* as appropriate.

(e) *Other rules*—(1) *Section 367(a) property with respect to which gain is recognized.* Except as otherwise provided in this paragraph (e)(1), gain recognized by the U.S. transferor pursuant to paragraph (c)(2) of this section will be treated as recognized with respect to the section 367(a) property transferred in the section 361 exchange in proportion to the amount of gain realized by the U.S. transferor on the transfer of each item of section 367(a) property. This paragraph (e)(1) will be applied after taking into account any gain or deemed dividends (including any deemed dividends under section 1248(a)) recognized by the U.S. transferor on the transfer of the section 367(a) property in the section 361 exchange pursuant to all other provisions of sections 367(a) and (b) and the regulations under that section. See, for example, §§1.367(a)–2T, 1.367(a)–3(e), 1.367(a)–4T, 1.367(a)–5T, 1.367(a)–6T, and 1.367(b)–4. If the U.S. transferor recognizes gain (including gain treated as a deemed dividend under section 1248(a)) pursuant to §1.367(a)–3(e)(3)(iii)(B) or (e)(3)(iii)(C) with respect to stock or securities transferred in the section 361 exchange, the realized gain in such stock or securities shall not be taken into account for purposes of applying this paragraph (e)(1) to gain recognized under paragraph (c)(2) of this section attributable to U.S. transferor shareholders described in §1.367(a)–3(e)(3)(iii)(B) or (e)(3)(iii)(C). Accordingly, gain recognized under paragraph (c)(2) attributable to such U.S. transferor shareholders shall not be treated as recognized with respect to such stock or securities under this paragraph. Furthermore, to the extent gain recognized by the U.S. transferor under paragraph (c)(2) is treated as recognized with respect to stock in a foreign corporation transferred in the section 361 exchange to which section 1248(a) applies, the portion of such gain treated as a deemed dividend under section 1248(a) is the product of the amount of the gain multiplied by the ratio of the amount that would be treated as a deemed dividend under section 1248(a) if all gain in the transferred stock were recognized under §1.367(a)–7(b) and the amount of gain realized in the transferred stock. See §1.367(a)–1T(b)(4) and §1.367(a)–1(b)(4)(i)(B) for additional rules on the character, source, and adjustments relating to gain recognized under section 367(a)(1), and §1.367(b)–2(e) for rules on the timing, treatment, and effect of amounts included in income as deemed dividends pursuant to regulations under section 367(b).

(2) *Relief for certain failures to comply that are not willful*—(i) *In general.* A control group member or U.S. transferor's failure to comply with any requirement of this section will be deemed not to have occurred for purposes of satisfying the requirements of this section if the control group member or U.S. transferor (or the foreign acquiring corporation on behalf of the U.S. transferor), as applicable, demonstrates that the failure was not willful using the procedure set forth in paragraph (e)(2)(ii) of this section. For this purpose, willful is to be interpreted consistent with the meaning of that term in the context of other civil penalties, which would include a failure due to gross negligence, reckless disregard, or willful neglect. Whether the failure to comply was a willful failure will be determined by the Director of Field Operations International, Large Business & International (or any successor to the roles and responsibilities of such person) (Director) based on all the facts and circumstances. The control group member or U.S. transferor (or the foreign acquiring corporation on behalf of the U.S. transferor), as applicable, must submit a request for relief and an explanation as provided in paragraph (e)(2)(ii) of this section. Although a U.S transferor whose failure to comply is determined not to be willful will not be subject to gain recognition under this section, the U.S. transferor will be subject to a penalty

under section 6038B if the U.S. transferor fails to demonstrate that the failure was due to reasonable cause and not willful neglect. See §1.6038B–1(b) and (f). The determination of whether the failure to comply was willful under this section has no effect on any request for relief made under §1.6038B–1(f).

(ii) *Procedures for establishing that a failure to comply was not willful*—(A) *Time and manner of submission.* A control group member or U.S. transferor's statement that the failure to comply was not willful will be considered only if, promptly after the control group member or U.S. transferor, as applicable, becomes aware of the failure, an amended return is filed for the taxable year to which the failure relates that includes the information that should have been included with the original return for such taxable year or that otherwise complies with the rules of this section, and that includes a written statement explaining the reasons for the failure to comply. The amended return must be filed with the Internal Revenue Service at the location where the taxpayer filed its original return. The U.S. transferor may submit a request for relief from the penalty under section 6038B as part of the same submission. See §1.6038B–1(f).

(B) *Notice requirement.* In addition to the requirements of paragraph (e)(2)(ii)(A) of this section, a control group member or U.S. transferor, as applicable, must comply with the notice requirements of this paragraph (e)(2)(ii)(B). If any taxable year of the control group member or U.S. transferor, as applicable, is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Internal Revenue Service personnel conducting the examination. If no taxable year of the control group member or U.S transferor, as applicable, is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Director.

(iii) For illustrations of the application of the willfulness standard of this paragraph (e)(2), see the examples in §1.367(a)–8(p)(3).

(3) *Anti-abuse rule.* Any property of the U.S. transferor acquired with a principal purpose of affecting any determination under this section (including, for example, the section 367(a) percentage, inside gain, or inside basis) shall not be taken in account for purposes of any determination under this section. Nothing in this paragraph (e)(3) constitutes a limitation on or modification to judicial doctrines, including step-transaction or substance-over-form.

(4) *Certain income inclusions under §1.367(b)–4*—(i) *Income inclusion attributable to U.S. transferor shareholder described in §1.367(a)–3(e)(3)(iii)(A).* If pursuant to §1.367(a)–3(e)(3)(iii)(B) or (e)(3)(iii)(C) the U.S. transferor is required to recognize gain on the transfer of foreign stock (all or a portion of which is treated as a deemed dividend under section 1248(a)), and if pursuant to §1.367(b)–4(b)(1)(i) the U.S. transferor is also required to include in income as a deemed dividend the section 1248 amount (within the meaning of §1.367(b)–2(c)) in the foreign stock, then the section 1248 amount included in income under §1.367(b)–4(b)(1)(i) is attributable to each U.S. transferor shareholder described in §1.367(a)–3(e)(3)(iii)(A) pursuant to this paragraph (e)(4)(i). The portion of the section 1248 amount attributable to each U.S. transferor shareholder described in §1.367(a)–3(e)(3)(iii)(A) is the portion of the section 1248 amount that bears the same ratio as such U.S. transferor shareholder's ownership interest percentage bears to the aggregate ownership interest percentage of all U.S. transferor shareholders described in §1.367(a)–3(e)(3)(iii)(A).

(ii) *Ordering rules for determining section 1248 amount.* The section 1248 amount (within the meaning of §1.367(b)–2(c)) included in income as a deemed dividend under §1.367(b)–4(b)(1)(i) is determined after taking into account any gain recognized under §§1.367(a)–3(e)(3)(iii)(B) or (e)(3)(iii)(C) or 1.367(a)–6T that is treated as a deemed dividend under section 1248(a). See §1.367(a)–3(e)(7) and paragraph (e)(5)(ii) of this section for rules to determine the amount of gain recognized

under §§1.367(a)–3(e)(3)(iii)(B) or (e)(3)(iii)(C) or 1.367(a)–6T, respectively, that is treated as a deemed dividend under section 1248(a).

(5) *Certain gain under §1.367(a)–6T*—(i) *Gain attributable to U.S. transferor shareholder described in §1.367(a)–3(e)(3)(iii)(A).* If pursuant to §1.367(a)–3(e)(3)(iii)(B) or (e)(3)(iii)(C), the U.S. transferor is required to recognize gain on the transfer of stock or securities, and if pursuant to §1.367(a)–6T the U.S. transferor is also required to recognize gain, then gain recognized under §1.367(a)–6T (including any portion treated as a deemed dividend under section 1248(a)) to the extent treated as recognized with respect to the stock or securities, is attributable to each U.S. transferor shareholder described in §1.367(a)–3(e)(3)(iii)(A) pursuant to this paragraph (e)(5)(i). The portion of the gain (including any portion treated as a deemed dividend under section 1248(a)) that is attributable to each U.S. transferor shareholder described in §1.367(a)–3(e)(3)(iii)(A) is the portion of the gain that bears the same ratio as such U.S. transferor shareholder's ownership interest percentage bears to the aggregate ownership interest percentage of all U.S. transferor shareholders described in §1.367(a)–3(e)(3)(iii)(A).

(ii) *Gain subject to section 1248(a).* If the U.S. transferor recognizes gain under §1.367(a)–6T with respect to transferred stock that is stock in a foreign corporation to which section 1248(a) applies, the portion of such gain treated as a deemed dividend under section 1248(a) is determined after taking into account any gain recognized under §1.367(a)–3(e)(3)(iii)(B) or (e)(3)(iii)(C) and the amount of such gain treated as a deemed dividend under section 1248(a) pursuant to §1.367(a)–3(e)(7).

(f) *Definitions.* The following definitions apply for purposes of this section:

(1) *Control group, control group member, and non-control group member*—(i) *General rule.* Except as provided in paragraph (f)(1)(ii) of this section, the *control group* is the group of five or fewer, but at least one, domestic corporations that controls (within the meaning of section 368(c)) the U.S. transferor immediately before the reorganization. If the U.S. transferor is owned directly by more than five domestic corporations immediately before the reorganization, but some combination of five or fewer domestic corporations controls the U.S. transferor, the U.S. transferor must designate the five or fewer domestic corporations that comprise the control group on Form 926, ''Return by a U.S. Transferor of Property to a Foreign Corporation.'' For purposes of identifying the control group, members of an affiliated group (within the meaning of section 1504) are treated as a single corporation. Except as provided in paragraph (f)(1)(ii) of this section, a *control group member* is a domestic corporation that is part of the control group. A *non-control group member* is a shareholder of the U.S. transferor immediately before the reorganization that is not a control group member.

(ii) *Exception for certain entities.* Regulated investment companies (as defined in section 851(a)), real estate investment trusts (as defined in section 856(a)), and S corporations (as defined in section 1361(a)) cannot be control group members.

(2) *Deductible liability* is any liability of the U.S. transferor that is assumed in the section 361 exchange if payment of the liability would give rise to a deduction.

(3) *Fair market value* is the fair market value determined without regard to mortgages, liens, pledges, or other liabilities. For this purpose, the fair market value of any property subject to a nonrecourse indebtedness shall be treated as being not less than the amount of any nonrecourse indebtedness to which such property is subject.

(4) *Inside basis* is the aggregate basis of the section 367(a) property transferred by the U.S. transferor in the section 361 exchange and, except as otherwise provided in this paragraph (f)(4), increased by any gain recognized or any deemed dividend included in income by the U.S. transferor under section 367 on the transfer of the section 367(a) property in the section 361 exchange, but not including any gain recognized under paragraph (c)(2) of this section. If the U.S. transferor transfers stock or securities and recognizes gain under §1.367(a)–3(e)(3)(iii)(B) or (e)(3)(iii)(C) with respect to such stock

or securities, then inside basis is not increased for gain recognized or deemed dividends included in income that are described in paragraph (f)(4)(i), (f)(4)(ii), or (f)(4)(iii) of this section.

(i) Gain recognized under §1.367(a)–3(e)(3)(iii)(B) or (e)(3)(iii)(C) (including any portion treated as a deemed dividend under section 1248(a));

(ii) Gain recognized under §1.367(a)–6T (including any portion treated as a deemed dividend under section 1248(a)) attributable to U.S. transferor shareholders described in §1.367(a)–3(e)(3)(iii)(A) (as determined pursuant to §1.367(a)–7(e)(5));

(iii) A deemed dividend included in income under §1.367(b)–4(b) attributable to U.S. transferor shareholders described in §1.367(a)–3(e)(3)(iii)(A) (as determined pursuant to §1.367(a)–7(e)(4)).

(5) *Inside gain* is the amount (but not below zero) by which the aggregate fair market value of the section 367(a) property transferred in the section 361 exchange exceeds the sum of:

(i) The inside basis; and

(ii) The product of the section 367(a) percentage multiplied by the aggregate deductible liabilities of the U.S. transferor.

(6) *Outside gain or loss* is the product of the section 367(a) percentage multiplied by the difference between—

(i) The aggregate fair market value of the stock received by a control group member in exchange for (or with respect to, as applicable) stock or securities of the U.S. transferor under section 354, 355, or 356, and

(ii) The control group member's aggregate section 358 basis (as defined in paragraph (c)(3) of this section) in such stock received, determined without regard to any adjustment to that basis under paragraph (c)(3) of this section.

(7) *Ownership interest percentage* is the ratio of the fair market value of the stock in the U.S. transferor owned by a shareholder to the fair market value of all of the outstanding stock of the U.S. transferor. Except as provided in this paragraph (f)(7), the ownership interest percentage of a shareholder is determined immediately before the reorganization. For purposes of determining the ownership interest percentage with respect to each shareholder, however, the numerator and denominator of the fraction are first reduced as described in this paragraph (f)(7). The numerator is reduced (but not below zero) by any distributions by the U.S. transferor of money or other property (within the meaning of section 356) to such shareholder pursuant to the plan of reorganization, but only to the extent such money or other property is not provided by the foreign acquiring corporation in exchange for property of the U.S. transferor acquired in the section 361 exchange. Furthermore, the denominator of the fraction is reduced (but not below zero) by all such distributions by the U.S. transferor to all shareholders. For illustrations of this definition, see paragraph (g) of this section, *Example 4* and *Example 5*.

(8) *Section 361 exchange* is an exchange described in section 361(a) or (b).

(9) *Section 367(a) percentage* is the ratio of the aggregate fair market value of the section 367(a) property transferred by the U.S. transferor in the section 361 exchange to the aggregate fair market value of all property transferred by the U.S. transferor in the section 361 exchange.

(10) *Section 367(a) property*. Except as provided in paragraph (e)(3) of this section, *section 367(a) property* is any property, as defined in §1.367(a)–1T(d)(4), other than section 367(d) property.

(11) *Section 367(d) property* is property described in section 936(h)(3)(B).

(12) *Timely filed return* is a U.S. income tax return filed on or before the due date set forth in section 6072(b), including any extensions of time to file the return granted under section 6081.

(13) *U.S. transferor shareholder* is a person that is either a control group member or a non-control group member.

(g) *Examples*. The rules of this section are illustrated by the examples set forth in this paragraph (g). See also §1.367(a)–3(e)(8), *Example 2* and *Example 3*. The analysis of the following examples is limited to a discussion of issues under this section. Unless otherwise indicated, for purposes of the following examples: DP1, DP2, and DC are domestic corporations that do not join in the filing of a consolidated return and none of which is a regulated investment company, a real estate investment

trust, or an S corporation; FP and FA are foreign corporations created or organized under the laws of Country B and are unrelated to DP1, DP2, and DC; each corporation has a single class of stock outstanding; each share of stock of DC owned by a shareholder of DC has an identical stock basis; Business A consists solely of section 367(a) property whose fair market value exceeds its basis and that, but for the application of this section, would qualify for the active foreign trade or business exception under §1.367(a)–2T; the fair market value of any FA stock received in a reorganization is equal to the fair market value of property exchanged therefor; FA is not a surrogate foreign corporation for purposes of section 7874 because one or more of the conditions of section 7874(a)(2)(B) is not satisfied; DC has no liabilities; DP1 and DP2 satisfy the requirements of paragraph (c)(5) of this section, and DC satisfies the requirements of §1.6038B–1(c)(6)(ii).

Example 1. Tainted assets and non-control group ownership. (i) *Facts.* DP1, DP2, and FP own 50%, 30%, and 20%, respectively, of the outstanding stock of DC. DP1 and DP2 are members of the same affiliated group within the meaning of section 1504. DP1's DC stock has a $120x basis and $100x fair market value. DP2's DC stock has a $50x basis and $60x fair market value. DC owns inventory with a $40x basis and a $100x fair market value. DC also owns Business A (excluding the inventory) with a $10x basis and $100x fair market value. In a reorganization described in section 368(a)(1)(F), DC transfers the inventory and Business A to FA, a newly formed corporation, in exchange for all of the outstanding stock of FA. DC's transfer of the inventory and Business A to FA qualifies as a section 361 exchange. DP1, DP2, and FP exchange the DC stock for a proportionate amount of FA stock pursuant to section 354.

(ii) *Result.* (A) Under section 367(a)(3)(B)(i), DC must recognize $60x gain ($100x fair market value less $40x basis) on the transfer of the inventory to FA. The basis of the inventory in the hands of FA is increased by the gain recognized of $60x (that is, increased from $40x to $100x). See §1.367(a)–1(b)(4)(i)(B). Under section 367(a)(5) and paragraph (b) of this section, DC's transfer of Business A to FA is subject to the general rule of section 367(a)(1). As a result, DC must also generally recognize $90x gain ($100x fair market value less $10x basis) on the transfer of Business A to FA notwithstanding the application of section 361 (or any other nonrecognition provision enumerated in section 367(a)(1)). However, if the conditions and requirements of paragraph (c) of this section are met, DC's transfer of Business A to FA would qualify for the active foreign trade or business exception provided by section 367(a)(3) and §1.367(a)–2T.

(B) The requirement of paragraph (c)(1) of this section is satisfied because DC is controlled (within the meaning of section 368(c)) by five or fewer domestic corporations immediately before the reorganization (in this case, by a single domestic corporation because DP1 and DP2 together own 80% of the stock of DC). DP1 and DP2 are treated as a single domestic corporation for this purpose under paragraph (f)(1)(i) of this section because DP1 and DP2 are members of the same affiliated group.

(C) Paragraph (c)(2)(i) of this section would be satisfied only if DC recognizes $18x gain on the transfer of Business A, which is the amount of inside gain attributable to FP, a non-control group member. The $18x gain equals the product of the inside gain ($90x) multiplied by FP's ownership interest percentage (20%) in DC, reduced by $0x (the sum of the amounts described in paragraphs (c)(2)(i)(A) through (c)(2)(i)(C) of this section). Under paragraph (f)(5) of this section, the $90x inside gain is the amount by which the aggregate fair market value ($200x) of the section 367(a) property (inventory and Business A) exceeds $110x, the sum of the inside basis of $110x and the product of the section 367(a) percentage (100%) multiplied by the deductible liabilities of DC ($0x). Under paragraph (f)(4) of this section, the inside basis equals the $50x aggregate basis of the section 367(a) property transferred in the section 361 exchange, increased by the $60x gain recognized by DC on the transfer of the inventory to FA, but not by the $18x gain recognized by DC under paragraph (c)(2)(i) of this section attributable to FP. The section 367(a) percentage is 100% because the only assets transferred are the inventory and Business A, which are section 367(a) property. Under paragraph (e)(1) of this section, the $18x gain recognized under paragraph (c)(2)(i) of this section is treated as recognized with respect to Business A. FA's basis in Business A as determined under section 362 is increased for the $18x gain recognized. See §1.367(a)–1(b)(4)(i)(B).

(D) Paragraph (c)(2)(ii) of this section is not applicable with respect to either DP1 or DP2 because the attributable inside gain with respect to each such shareholder can be preserved in the FA stock received. As stated in paragraph (ii)(C) of this *Example 1*, the amount of the inside gain is $90x. The attributable inside gain with respect to DP1 of $45x (equal to the product of $90x inside gain multiplied by DP1's 50% ownership interest percentage, reduced by $0x (the sum of the amounts described in paragraphs (c)(2)(ii)(A)(*1*) through (c)(2)(ii)(A)(*3*) of this section)) does not exceed $100x (equal to the

product of the section 367(a) percentage of 100% multiplied by $100x fair market value of FA stock received by DP1). Similarly, the attributable inside gain with respect to DP2 of $27x (equal to the product of $90x inside gain multiplied by DP2's 30% ownership interest percentage, reduced by $0x (the sum of the amounts described in paragraphs (c)(2)(ii)(A)(*1*) through (c)(2)(ii)(A)(*3*) of this section)) does not exceed $60x (equal to the product of the section 367(a) percentage of 100% multiplied by $60x fair market value of FA stock received by DP2).

(E) Each control group member (DP1 and DP2) separately computes any required adjustment to stock basis under paragraph (c)(3) of this section. DP1's section 358 basis in the FA stock received of $120x (the amount of DP1's basis in the DC stock exchanged) is reduced to preserve the attributable inside gain with respect to DP1, less any gain recognized with respect to DP1 under paragraph (c)(2)(ii) of this section. Because DC does not recognize gain on the section 361 exchange with respect to DP1 under paragraph (c)(2)(ii) of this section (as determined in paragraph (ii)(D) of this *Example 1*), the attributable inside gain of $45x with respect to DP1 is not reduced under paragraph (c)(3)(i)(B) of this section. DP1's outside loss in the FA stock is $20x, the product of the section 367(a) percentage of 100% multiplied by $20x loss (equal to the difference between $100x fair market value and $120x section 358 basis in FA stock). Thus, DP1's $120x section 358 basis in the FA stock must be reduced by $65x (excess of $45x, reduced by $0x, over $20x outside loss) to $55x.

(F) DP2's aggregate section 358 basis in the FA stock received of $50x (the amount of DP2's basis in the DC stock exchanged) is reduced to preserve the attributable inside gain with respect to DP2, less any gain recognized with respect to DP2 under paragraph (c)(2)(ii) of this section. Because DC does not recognize gain on the section 361 exchange with respect to DP2 (as determined in paragraph (ii)(D) of this *Example 1*), the attributable inside gain of $27x with respect to DP2 is not reduced under paragraph (c)(3)(i)(A) of this section. DP2's outside gain in the FA stock is $10x, the product of the section 367(a) percentage of 100% multiplied by $10x gain (equal to the difference between $60x fair market value and $50x section 358 basis in FA stock). Thus, DP2's $50x section 358 basis in the FA stock must be reduced by $17x (excess of $27x, reduced by $0x, over the $10x outside gain) to $33x.

(G) Paragraph (c)(4) of this section would be satisfied only if DC complies with the requirements of §1.6038B–1(c)(6)(iii), including filing with its timely filed return for the year of the reorganization a statement agreeing to file an amended return reporting the gain realized but not recognized on the section 361 exchange in certain cases if a significant amount of the section 367(a) property received in the section 361 exchange is disposed of, directly or indirectly, in one or more related transactions within the prescribed 60-month period.

Example 2. Triangular reorganization involving an exchange of section 367(a) property for foreign stock and cash. (i) *Facts.* (A) DP1 wholly owns DC. DP1 and DC file a consolidated return. DP1's DC stock has a $170x basis and $200x fair market value. DC owns Business A, which has a $10x basis and $200x fair market value. FP wholly owns FA.

(B) In a triangular reorganization described in section 368(a)(1)(A) by reason of section 368(a)(2)(D), DC transfers Business A to FA in exchange for $180x of FP stock and $20x cash. DC's transfer of Business A to FA qualifies as a section 361 exchange. DP1 exchanges its DC stock for $180x of FP stock and $20x cash pursuant to section 356. The triangular reorganization constitutes an indirect stock transfer under §1.367(a)–3(d)(1)(i), and DP1 properly files a gain recognition agreement under §1.367(a)–8 with respect to the transfer. See also §1.367(a)–3(d)(2)(vii).

(ii) *Result.* (A) Under section 367(a)(5) and paragraph (b) of this section, DC's transfer of Business A to FA is subject to the general rule of section 367(a)(1). As a result, DC must generally recognize $190x gain ($200x fair market value less $10x basis) on the transfer of Business A to FA notwithstanding the application of section 361 (or any other nonrecognition exchange enumerated in section 367(a)(1)). However, if the requirements of paragraph (c) of this section are satisfied, DC's transfer of Business A to FA would qualify for the active foreign trade or business exception provided in section 367(a)(3) and §1.367(a)–2T.

(B) The requirement of paragraph (c)(1) of this section is satisfied because DC is controlled (within the meaning of section 368(c)) by five or fewer domestic corporations immediately before the reorganization (in this case, by a single domestic corporation, DP1).

(C) DC is not required to recognize gain under paragraph (c)(2)(i) of this section because, immediately before the reorganization, DC is wholly owned by DP1, a control group member. In addition, DP1's ownership interest percentage is 100%. Paragraph (c)(2)(ii) of this section would be satisfied only if DC recognizes $10x gain, computed as the amount by which the attributable inside gain with respect to DP1 of $190x (the product of $190x inside gain multiplied by DP1's ownership interest percentage of 100%, reduced by $0x (the sum of the amounts in paragraphs (c)(2)(ii)(A)(*1*) through (c)(2)(ii)(A)(*3*) of this section)) exceeds $180x (the product of the section 367(a) percentage of 100% multiplied by $180x fair market value of FP stock received by DP1). Under paragraph (f)(5) of this section, the $190x inside

gain is the amount by which the $200x aggregate fair market value of Business A exceeds $10x (the sum of the inside basis of $10x and the product of the section 367(a) percentage (100%) multiplied by the deductible liabilities of DC ($0x)). Under paragraph (f)(4) of this section, the inside basis equals the $10x aggregate basis of the section 367(a) property transferred in the section 361 exchange (not increased by the $10x gain recognized by DC under paragraph (c)(2)(ii) of this section). The section 367(a) percentage is 100% because the only asset transferred is Business A, which is section 367(a) property. Under §1.1502–32(b)(2), DP1 increases the basis of its DC stock by the $10x gain recognized, that is, from $170x to $180x. Under paragraph (e)(1) of this section, the $10x gain recognized under paragraph (c)(2)(ii) of this section is treated as recognized with respect to Business A. FA's basis in Business A as determined under section 362 is increased for the $10x gain recognized. See §1.367(a)–1(b)(4)(i)(B).

(D) Paragraph (c)(3) of this section would be satisfied only if DP1's section 358 basis in the FP stock is reduced by the amount by which the attributable inside gain with respect to DP1, reduced by any gain recognized by DC with respect to DP1 under paragraph (c)(2)(ii) of this section, exceeds DP1's outside gain in the FP stock. DP1's section 358 basis in the FP stock is $180x, computed as $180x basis in DC stock, as determined in paragraph (ii)(C) of this *Example 2*, decreased by $20x cash received and increased by $20x gain recognized under section 356 (such amount equal to the lesser of the $20x cash received and the $20x gain in the DC stock, computed as $200x fair market value less $180x basis). Because DC recognizes $10x gain on the section 361 exchange with respect to DP1 under paragraph (c)(2)(ii) of this section as determined in paragraph (ii)(C) of this *Example 2*, the $190x attributable inside gain with respect to DP1 is reduced by $10x to $180x under paragraph (c)(3)(i)(C) of this section. DP1's outside gain in the FP stock is $0x, the product of the section 367(a) percentage of 100% multiplied by $0x gain (the difference between $180x fair market value and $180x section 358 basis in FP stock). Thus, DP1's section 358 basis in the FP stock ($180x) must be reduced by $180x ($190x attributable inside gain reduced by $10x) to $0x.

(E) Paragraph (c)(4)(i) of this section would be satisfied only if DC complies with the requirements of §1.6038B–1(c)(6)(iii), including filing with its tax return for the year of the reorganization a statement agreeing to file an amended return reporting the gain on the section 361 exchange in certain cases if a significant amount of the section 367(a) property received in the section 361 exchange is disposed of, directly or indirectly, in one or more related transactions within the prescribed 60-month period.

Example 3. Adjustment to basis of multiple blocks of stock; transfer of section 367(d) property. (i) *Facts.* (A) DP1 wholly owns DC. One half of DP1's shares of stock in DC, each with an identical basis, has an aggregate basis of $60x and fair market value of $100x (Block 1). The other one half of DP's shares of stock in DC, each with an identical basis, has an aggregate basis of $120x and fair market value of $100x (Block 2). DC owns Business A ($15x basis and $150x fair market value) (excluding the patent) and a patent ($0x basis and $50x fair market value). The patent is section 367(d) property.

(B) In a reorganization described in section 368(a)(1)(F), DC transfers Business A and the patent to FA, a newly formed corporation, in exchange for 2 shares of FA stock. DC's transfer of Business A and the patent to FA qualifies as a section 361 exchange. DP1 exchanges Block 1 and Block 2 for the two shares of FA stock pursuant to section 354. Pursuant to §1.358–2(a)(2)(i), one share of the FA stock corresponds to Block 1 (Share 1) and the other share of FA stock corresponds to Block 2 (Share 2). The basis of Share 1 and Share 2 correspond to the basis of Block 1 and Block 2, respectively.

(ii) *Result.* (A) Under section 367(a)(5) and paragraph (b) of this section, DC's transfer of Business A to FA is subject to the general rule of section 367(a)(1). As a result, DC must generally recognize $135x of gain on the transfer of Business A to FA notwithstanding the application of section 361 (or any other nonrecognition exchange described in section 367(a)(1)). However, if the requirements of paragraph (c) of this section are met, DC's transfer of Business A to FA would qualify for the active foreign trade or business exception provided in section 367(a)(3). For rules applicable to DC's transfer of the patent to FA, see section 367(d).

(B) The requirement of paragraph (c)(1) of this section is satisfied because DC is controlled (within the meaning of section 368(c)) by five or fewer domestic corporations immediately before the reorganization (in this case, by a single domestic corporation, DP1).

(C) Paragraph (c)(2)(i) of this section is not applicable because, immediately before the reorganization, DC is wholly owned by DP1, a control group member. In addition, DP1's ownership interest percentage is 100%. Paragraph (c)(2)(ii) of this section is not applicable because the attributable inside gain with respect to DP1 can be preserved in the FA stock received. The attributable inside gain with respect to DP1 of $135x (equal to the product of $135x inside gain multiplied by DP1's 100% ownership interest percentage, reduced by $0x (the sum of the amounts in paragraphs (c)(2)(ii)(A)(*1*) through (c)(2)(ii)(A)(*3*) of this section)) does not exceed $150x (equal to the product of the section 367(a) percentage of 75% multiplied by $200x fair market value of FA stock received

by DP1). Under paragraph (f)(5) of this section, the $135x inside gain is the amount by which the aggregate fair market value of Business A ($150x) exceeds $15x, the sum of the inside basis of Business A ($15x) and the product of the section 367(a) percentage (75%) multiplied by the deductible liabilities of DC ($0x). Under paragraph (f)(4) of this section, the inside basis equals the $15x aggregate basis of the section 367(a) property transferred in the exchange. The section 367(a) percentage of 75% is equal to the ratio of the fair market value of the section 367(a) property ($150x for Business A) to the fair market value of all the property transferred ($200x, the sum of $150x for Business A and $50x for the patent).

(D) Under paragraph (c)(3) of this section, DP1's aggregate section 358 basis of $180x in the stock of FA (computed as the sum of $60x basis in Share 1 and $120x basis in Share 2) is reduced by the amount by which the attributable inside gain with respect to DP1, reduced by any gain recognized by DC with respect to DP1 under paragraph (c)(2)(ii) of this section, exceeds DP1's outside gain in the FP stock received. Because DC recognizes no gain on the section 361 exchange with respect to DP1 under paragraph (c)(2)(ii) of this section as determined in paragraph (ii)(C) of this *Example 3*, the $135x attributable inside gain with respect to DP1 is not reduced under paragraph (c)(3)(i)(A) of this section. DP1's outside gain in Share 1 and Share 2 in the aggregate is $15x, the product of the section 367(a) percentage of 75% multiplied by $20x (the difference between $200x aggregate fair market value and $180x aggregate section 358 basis in the FA stock received by DP1). Thus, DP1's section 358 basis in the FA stock ($180x) must be reduced by $120x (the excess of $135x attributable inside gain, reduced by $0x, over $15x outside gain) to $60x.

(E) Under paragraph (c)(3)(iii) of this section, the $120x reduction to basis is allocated between Share 1 and Share 2 based on the relative section 358 basis of each share. Therefore, the basis in Share 1 is reduced by $40x ($120x multiplied by $60x/$180x). As adjusted, DP1's basis in Share 1 is $20x ($60x less $40x). The basis in Share 2 is reduced by $80x ($120x multiplied by $120x/$180x). As adjusted, DP1's basis in Share 2 is $40x ($120x less $80x).

(F) Paragraph (c)(4)(i) of this section would be satisfied only if DC complies with the requirements of §1.6038B–1(c)(6)(iii), including filing with its tax return for the year of the reorganization, a statement agreeing to file an amended return reporting the gain realized but not recognized on the section 361 exchange in certain cases if a significant amount of the section 367(a) property received in the section 361 exchange is disposed of, directly or indirectly, in one or more related transactions within the prescribed 60-month period.

Example 4. Control requirement and ownership interest percentage; non-qualified property provided by foreign acquiring corporation. (i) *Facts.* DP1 and FP own 80% and 20%, respectively, of the outstanding stock of DC. DC owns Business A with a basis of $0x and $100x fair market value. DP1's DC stock has a fair market value of $80x, and FP's DC stock has a fair market value of $20x. In a reorganization described in section 368(a)(1)(D), DC transfers Business A to FA in exchange for $80x of FA stock and $20x cash. DC's transfer of Business A to FA qualifies as a section 361 exchange. DP1 exchanges its $80x of DC stock for $60x of FA stock and $20x cash, and FP exchanges its $20x of DC stock for $20x of FA stock.

(ii) *Result.* (A) The requirement of paragraph (c)(1) of this section is satisfied because DC is controlled (within the meaning of section 368(c)) by five or fewer domestic corporations immediately before the reorganization (in this case, by a single domestic corporation, DP1). The fact that the $20x cash is distributed solely to DP1 does not change the analysis of the control requirement. The control requirement is determined immediately before the reorganization and is not affected by distributions of property.

(B) Pursuant to paragraph (f)(7) of this section, the ownership interest percentages of DP1 and FP immediately before the reorganization are 80% ($80x/($80x + $20x)) and 20% ($20x/($80x + $20x)), respectively. The fact that the $20x of cash is distributed solely to DP1 does not change this result. The distribution of the $20x of cash is not taken into account for purposes of the ownership interest percentage computation because the $20x of cash distributed by DC is provided by FA to DC in the section 361 exchange.

Example 5. Control requirement and ownership interest percentage; non-qualified property provided by U.S. transferor. (i) *Facts.* The facts are the same as in *Example 4*, except as follows. Business A has a fair market value of $80x (and not $100x) and DC also owns inventory with a basis of $0x and fair market value of $20x. DC transfers Business A, but not the inventory, to FA in exchange for $80x of FA stock. DP1 exchanges its $80x of DC stock for $60x of FA stock and the $20x of inventory, and FP exchanges its $20x of DC stock for $20x of FA stock.

(ii) *Result.* (A) The requirement of paragraph (c)(1) of this section is satisfied because DC is controlled (within the meaning of section 368(c)) by five or fewer domestic corporations immediately before the reorganization (in this case, by a single domestic corporation, DP1). The fact that the $20x of inventory is not transferred to FA, but is instead distributed solely to DP1, does not

change the analysis of the control requirement. The control requirement is determined immediately before the reorganization, and is not affected by distributions of property.

(B) Pursuant to the general rule of paragraph (f)(7) of this section, the ownership interest percentages of DP1 and FP immediately before the reorganization would be 80% ($80x/($80x + $20x)) and 20% ($20x/($80x + $20x)), respectively. In this case, however, the distribution of the $20x inventory to DP1 is taken into account for purposes of computing the ownership interest percentage of DP1 and FP because the inventory is not provided by FA to DC in the section 361 exchange. With respect to DP1, the numerator of the ownership interest percentage computation is $60x, computed as the fair market value of DC stock owned by DP1 immediately before the reorganization but reduced by the fair market value of the inventory distributed to DP1 ($80x less $20x). With respect to FP, the numerator of the ownership interest percentage computation is $20x, the fair market value of the DC stock owned by FP immediately before the reorganization. With respect to both DP1 and FP, the denominator of the ownership interest percentage computation is $80x, computed as the fair market value of all DC stock immediately before the reorganization, but reduced by the fair market value of the inventory distributed to DP1 ($100x, less $20x). Accordingly, the ownership interest percentage of DP1 is 75% ($60x/$80x), and the ownership interest percentage of FP is 25% ($20x/$80x).

(h) *Applicable cross-references.* For rules relating to the character, source, and adjustments resulting from gain recognized by a U.S. transferor under section 367(a), see §1.367(a)–1(b)(4)(i)(B) and §1.367(a)–1T(b)(4). For rules relating to transfers of stock or securities in a section 361 exchange, see §1.367(a)–3(e). For rules relating to the acquisition of the stock or assets of a foreign corporation by another foreign corporation, see §1.367(b)–4. For rules relating to transfers of section 367(d) property by a U.S. transferor to a foreign corporation, see section 367(d). For rules relating to distributions of stock of a foreign corporation by a domestic corporation under section 355 or 361, see §§1.367(b)–5, 1.367(e)–1, and 1.1248(f)–1 through 1.1248(f)–3. For additional rules relating to certain reporting requirements of a U.S. transferor, see §1.6038B–1. For rules regarding expatriated entities, see section 7874 and the regulations under that section.

(i) [Reserved]

(j) *Effective/applicability dates.* Except for paragraph (e)(2) of this section, this section applies to transfers occurring on or after April 18, 2013. Paragraph (e)(2) applies to requests for relief submitted on or after November 19, 2014. Paragraph (e)(2) of this section also applies to requests for relief submitted before November 19, 2014 if the statute of limitations on the assessment of tax has not expired for any year to which the request relates and the control group member or U.S. transferor, as applicable, resubmits the request under paragraph (e)(2) of this section and notes, on the request, that the request is being submitted pursuant to the third sentence of this paragraph (j). See paragraph (e)(2) of this section, as contained in 26 CFR part 1 revised as of April 1, 2014, for requests for relief submitted after April 17, 2013, and before November 19, 2014, that are not resubmitted under paragraph (e)(2) of this section.

[T.D. 9614, 78 FR 17032, Mar. 19, 2013, as amended by T.D. 9704, 79 FR 68767, Nov. 19, 2014; T.D. 9760, 81 FR 15169, Mar. 22, 2016]

§1.367(a)–8 Gain recognition agreement requirements.

(a) *Scope.* This section provides the terms and conditions for a gain recognition agreement entered into by a United States person pursuant to §1.367(a)–3(b) through (e) in connection with a transfer of stock or securities to a foreign corporation pursuant to an exchange that would otherwise be subject to section 367(a)(1). Paragraph (b) of this section provides definitions and special rules. Paragraphs (c) through (h) of this section identify the form, content, and other conditions of a gain recognition agreement. Paragraph (i) of this section is reserved. Paragraph (j) of this section identifies certain events that may require gain to be recognized under a gain recognition agreement. Paragraph (k) of this section provides exceptions for certain events that would otherwise require gain to be recognized under a gain recognition agreement. Paragraph (l) of this section is reserved. Paragraph (m) of this section provides rules that require gain to be recognized under a gain recognition agreement in connection with certain events to which an exception

under paragraph (k) of this section otherwise applies. Paragraph (n) of this section provides special rules in the case of a distribution of property with respect to stock to which section 301 applies. Paragraph (o) of this section provides rules for certain transactions that terminate or reduce the amount of gain subject to a gain recognition agreement. Paragraph (p) of this section provides relief for certain failures to file an initial gain recognition agreement (as defined in paragraph (b)(1)(vi) of this section) or to comply with the requirements of this section with respect to a gain recognition agreement (as described in paragraph (c) of this section). Paragraph (q) of this section provides examples that illustrate the rules of the section. Paragraph (r) of this section provides effective dates for the provisions of this section.

(b) *Definitions and special rules.* The following definitions and special rules apply for purposes of this section.

(1) *Definitions*—(i) *Asset reorganization*—(A) *General rule.* Except as provided in paragraph (b)(1)(i)(B) of this section, *an asset reorganization* is a reorganization described in section 368(a)(1) that involves an exchange of property described in section 361(a) or (b) (a section 361 exchange).

(B) *Exceptions.* An asset reorganization does not include the following:

(*1*) A reorganization described in section 368(a)(1)(D) or (G) if the requirements of section 354(b)(1)(A) and (B) are not met.

(*2*) For purposes of paragraphs (j)(2)(ii)(B), (k)(6)(ii), and (k)(6)(iii) of this section, a triangular asset reorganization. For rules applicable to a triangular asset reorganization, see paragraph (k)(7) of this section.

(ii) *A consolidated group* has the meaning set forth in §1.1502–1(h).

(iii) *Disposition.* Except as provided in this paragraph (b)(1)(iii), a *disposition* includes any transfer that would constitute a disposition for any purpose of the Internal Revenue Code. A disposition includes an indirect disposition of the stock of the transferred corporation as described in §1.367(a)–3(d). Except as provided in paragraph (n)(1) of this section, a disposition does not include the receipt of a distribution of property with respect to stock to which section 301 applies (including by reason of section 302(d)). See paragraphs (n)(2) and (o)(3) of this section for rules that apply if gain is recognized under section 301(c)(3). A complete or partial disposition by installment sale (under section 453) shall be treated as a disposition in the year of the installment sale.

(iv) A *gain recognition agreement document* means any agreement, statement, schedule, or form required to be filed under this section, including an initial gain recognition agreement (as defined in paragraph (b)(1)(vi) of this section), a new gain recognition agreement described in paragraph (c)(5) of this section, a Form 8838 extending the period of limitations on assessment of tax described in paragraph (f) of this section, and an annual certification described in paragraph (g) of this section.

(v) A *gain recognition event* is an event described in paragraphs (j) through (o) of this section that requires gain to be recognized under a gain recognition agreement.

(vi) An *initial gain recognition agreement* means the gain recognition agreement entered into under paragraph (c) of this section with respect to the initial transfer.

(vii) The *initial transfer* means a transfer of stock or securities (transferred stock or securities) to a foreign corporation pursuant to an exchange that would otherwise be subject to section 367(a)(1) but with respect to which a gain recognition agreement is entered into by a United States person pursuant to §1.367(a)–3(b) through (e).

(viii) An *intercompany item* has the meaning set forth in §1.1502–13(b)(2).

(ix) An *intercompany transaction* has the meaning set forth in §1.1502–13(b)(1).

(x) A *nonrecognition transaction* has the meaning set forth in section 7701(a)(45). In addition, a nonrecognition transaction includes an exchange described in section 351(b) or 356 even if all gain realized in the exchange is recognized.

(xi) The terms *P*, *S*, and *T* have the meanings set forth in §1.358–6(b)(1)(i), (ii), and (iii), respectively.

(xii) The determination of whether *substantially all* of the assets of the

transferred corporation have been disposed of is based on all the facts and circumstances.

(xiii) A *timely filed return* means a Federal income tax return filed on or before the last date prescribed for filing (taking into account any extensions of time therefor) such return.

(xiv) *Transferee foreign corporation.* Except as provided in this paragraph (b)(1)(xiv), the *transferee foreign corporation* is the foreign corporation to which the transferred stock or securities are transferred in an initial transfer. In the case of an indirect stock transfer, the transferee foreign corporation has the meaning set forth in §1.367(a)–3(d)(2)(i). The transferee foreign corporation also includes a corporation designated as the transferee foreign corporation in the case of a new gain recognition agreement entered into under this section.

(xv) *Transferred corporation.* Except as provided in this paragraph (b)(1)(xv), the *transferred corporation* is the corporation the stock or securities of which are transferred in the initial transfer. In the case of an indirect stock transfer, the transferred corporation has the meaning set forth in §1.367(a)–3(d)(2)(ii). The transferred corporation also includes a corporation designated as the transferred corporation in the case of a new gain recognition agreement entered into under this section.

(xvi) A *triangular asset reorganization* is a reorganization described in §1.358–6(b)(2)(i), (ii), (iii), or (v).

(xvii) The *U.S. transferor* is the United States person (as defined in §1.367(a)–1T(d)(1)) that transfers the transferred stock or securities to the transferee foreign corporation in the initial transfer. For purposes of determining the U.S. transferor in the case of a transfer by a partnership, see §1.367(a)–1T(c)(3)(i). The *U.S. transferor* also includes the United States person designated as the U.S. transferor in the case of a new gain recognition agreement entered into under this section including, for example, under paragraph (k)(14) of this section.

(2) *Special rules*—(i) *Stock deemed received or transferred.* References to stock received include stock deemed received (for example, pursuant to section 367(c)(2)). References to a transfer of stock or securities include a deemed transfer of stock or securities.

(ii) *Stock of the transferee foreign corporation.* References to stock of the transferee foreign corporation include any stock of the transferee foreign corporation the basis of which is determined, in whole or in part, by reference to the basis of the stock of the transferee foreign corporation received by the U.S. transferor in the initial transfer.

(iii) *Transferred stock or securities.* References to transferred stock or securities include any stock or securities of the transferred corporation the basis of which is determined, in whole or in part, by reference to the basis of the stock or securities transferred in the initial transfer.

(c) *Gain recognition agreement*—(1) *Terms of agreement*—(i) *General rule.* Except as provided in this paragraph (c)(1)(i), if a gain recognition event occurs during the period beginning on the date of the initial transfer and ending as of the close of the fifth full taxable year (not less than 60 months) following the close of the taxable year in which the initial transfer occurs (GRA term), the U.S. transferor must include in income the gain realized but not recognized on the initial transfer by reason of entering into the gain recognition agreement. In the case of a gain recognition event that occurs as a result of a partial disposition of stock, securities, or a partnership interest, as applicable, the U.S. transferor is required to recognize a proportionate amount of the gain subject to the gain recognition agreement, determined based on the fair market value of the stock, securities, or partnership interest, as applicable, disposed of (measured at the time of the partial disposition) as compared to the fair market value of all the stock, securities, or partnership interest, as applicable (measured at the time of the partial disposition). If the U.S. transferor must recognize gain under this paragraph as a result of an event described in paragraph (m) or (n) of this section, see those paragraphs to determine the amount of the gain that must be recognized. The amount of gain subject to the gain recognition agreement shall

be reduced by the amount of gain recognized under this paragraph. If the amount of gain subject to the gain recognition agreement is reduced to zero, the gain recognition agreement shall terminate without further effect.

(ii) *Ordering rule for gain recognized under multiple gain recognition agreements.* If a gain recognition event occurs that requires gain to be recognized under multiple gain recognition agreements, gain shall first be recognized under the gain recognition agreement that relates to the earliest initial transfer, then under the gain recognition agreement that relates to the immediately following initial transfer and so forth until the appropriate amount of gain has been recognized under each gain recognition agreement. The amount of gain recognized under a gain recognition agreement shall be determined after taking into account, as appropriate, any increase to basis (including the basis of the transferred stock or securities) under paragraph (c)(4) of this section resulting from gain recognized under another gain recognition agreement. For an illustration of this ordering rule, see paragraph (q)(2) of this section, *Example 6.*

(iii) *Taxable year in which gain is reported*—(A) *Year of initial transfer.* Except as provided in paragraph (c)(1)(iii)(B) of this section, the U.S. transferor must report any gain recognized under paragraph (c)(1)(i) of this section on an amended Federal income tax return for the taxable year of the initial transfer. The amended return must be filed on or before the 90th day following the date on which the gain recognition event occurs.

(B) *Year of gain recognition event.* If an election under paragraph (c)(2)(vi) of this section is made with the gain recognition agreement or if paragraph (c)(5)(ii) of this section applies to the gain recognition agreement, the U.S. transferor must report any gain recognized under paragraph (c)(1)(i) of this section on its Federal income tax return for the taxable year during which the gain recognition event occurs. If an election under paragraph (c)(2)(vi) of this section is made with the gain recognition agreement or if paragraph (c)(5)(ii) of this section applies to the gain recognition agreement but the U.S. transferor does not report the gain recognized on its Federal income tax return for the taxable year during which the gain recognition event occurs, the Commissioner may require the U.S. transferor to report the gain on an amended Federal income tax return for the taxable year during which the initial transfer occurred.

(iv) *Offsets.* No special limitations apply with respect to offsetting gain recognized under paragraph (c)(1)(i) of this section with net operating losses, capital losses, credits against tax, or similar items.

(v) *Payment and reporting of interest.* Interest must be paid on any additional tax due with respect to gain recognized by the U.S. transferor under paragraph (c)(1)(i) of this section. Any interest due shall be determined based on the rates under section 6621 for the period between the date that was prescribed for filing the Federal income tax return of the U.S. transferor for the year of the initial transfer and the date on which the additional tax due is paid. If paragraph (c)(1)(iii)(B) of this section applies, any interest due must be included with the payment of tax due with the Federal income tax return of the U.S. transferor for the taxable year during which the gain recognition event occurs (or should reduce the amount of any refund due to the U.S. transferor for such taxable year). A schedule entitled ''Calculation of Section 367 Tax and Interest'' that separately identifies and calculates any additional tax and interest due must be included with the Federal income tax return on which any interest due is reported.

(2) *Content of gain recognition agreement.* The gain recognition agreement must be entitled ''GAIN RECOGNITION AGREEMENT UNDER §1.367(a)–8'' and include the information described in paragraphs (c)(2)(i) through (viii) of this paragraph with the corresponding paragraph numbers. The information required under this paragraph (c)(2) and paragraph (c)(3) of this section must be included in the gain recognition agreement as filed.

(i) A statement that the document constitutes an agreement by the U.S.

transferor to recognize gain in accordance with the requirements of this section.

(ii) A description of the transferred stock or securities and other information as required in paragraph (c)(3) of this section.

(iii) A statement that the U.S. transferor agrees to comply with all the conditions and requirements of this section, including to recognize gain under the gain recognition agreement in accordance with paragraph (c)(1)(i) of this section, to extend the period of limitations on assessment of tax as provided in paragraph (f) of this section, to file the certification described in paragraph (g) of this section, and, as provided in paragraph (j)(8) of this section, to treat a failure to comply (as described in paragraph (j)(8) of this section) as extending the period of limitations on assessment of tax for the taxable year in which gain is required to be reported.

(iv) A statement that arrangements have been made to ensure that the U.S. transferor is informed of any events that affect the gain recognition agreement, including triggering events or other gain recognition events.

(v) In the case of a new gain recognition agreement filed under this section—

(A) A description of the event (such as a triggering event) and the applicable exception, if any, that gave rise to the new gain recognition agreement (such as a triggering event exception), including the date of the event and the name, address, and taxpayer identification number (if any) of each person that is a party to the event;

(B) As applicable, a description of the class, amount, and characteristics of the stock, securities or partnership interest received in the transaction; and

(C) As applicable, a calculation of the amount of gain that remains subject to the new gain recognition agreement as a result of the application of paragraph (m), (n), or (o) of this section.

(vi) A statement whether the U.S. transferor elects to include in income any gain recognized under paragraph (c)(1)(i) of this section in the taxable year during which a gain recognition event occurs. See paragraph (c)(5)(ii) of this section for a rule that requires, in certain cases, for the gain recognized pursuant to a new gain recognition agreement to be included in income during the taxable year in which the gain recognition event occurs.

(vii) A statement whether a gain recognition event has occurred during the taxable year of the initial transfer.

(viii) A statement describing any disposition of assets of the transferred corporation during such taxable year other than in the ordinary course of business.

(3) *Description of transferred stock or securities and other information.* The gain recognition agreement shall include the following:

(i) A description of the transferred stock or securities including—

(A) The type or class, amount, and characteristics of the transferred stock or securities;

(B) A calculation of the amount of the built-in gain in the transferred stock or securities that are subject to the gain recognition agreement, reflecting the basis and fair market value on the date of the initial transfer;

(C) The amount of any gain recognized by the U.S. transferor on the initial transfer; and

(D) The percentage (by voting power and value) that the transferred stock (if any) represents of the total stock outstanding of the transferred corporation on the date of the initial transfer.

(ii) The name, address, place of incorporation, and taxpayer identification number (if any) of the transferred corporation.

(iii) The date on which the U.S. transferor acquired the transferred stock or securities.

(iv) The name, address and place of incorporation of the transferee foreign corporation, and a description of the stock or securities received by the U.S. transferor in the initial transfer, including the percentage of stock (by vote and value) of the transferee foreign corporation received in such exchange.

(v) If the initial transfer is described in §1.367(a)–3(e), a statement that the conditions of section 367(a)(5) and any regulations under that section have been satisfied, and a description of any adjustments to the basis of the stock

received in the transaction or other adjustments made pursuant to section 367(a)(5) and any regulations under that section.

(vi) If the transferred corporation is domestic, a statement describing the application of section 7874 to the transaction, and indicating that the requirements of §1.367(a)–3(c)(1) are satisfied.

(vii) If the transferred corporation is foreign, a statement indicating whether the U.S. transferor was a section 1248 shareholder (as defined in §1.367(b)–2(b)) of the transferred corporation immediately before the initial transfer, and whether the U.S. transferor is a section 1248 shareholder with respect to the transferee foreign corporation immediately after the initial transfer, and whether any reporting requirements or other rules contained in regulations under section 367(b) are applicable, and, if so, whether they have been satisfied.

(viii) If the initial transfer involves a transfer by a partnership (see §1.367(a)–1T(c)(3)(i)) or a transfer of a partnership interest (see section 367(a)(4) and §1.367(a)–1T(c)(3)(ii)) a complete description of the transfer, including a description of the partners in the partnership.

(ix) If the transaction involved the transfer of property other than the transferred stock or securities and the transaction was subject to the indirect stock transfer rules of §1.367(a)–3(d), a statement indicating whether—

(A) The reporting requirements under section 6038B have been satisfied with respect to the transfer of such other property;

(B) Whether gain was recognized under section 367(a)(1);

(C) Whether section 367(d) applied to the transfer of such property; and

(D) Whether the other property transferred qualified for the active foreign trade or business exception under section 367(a)(3).

(4) *Basis adjustments for gain recognized.* The following basis adjustments shall be made if gain is recognized under paragraph (c)(1)(i) of this section.

(i) *Stock or securities of transferee foreign corporation.* The basis of the stock or securities, as applicable, of the transferee foreign corporation received by the U.S. transferor in the initial transfer shall be increased as of the date of the initial transfer by the amount of gain recognized.

(ii) *Transferred stock or securities.* The basis of the transferred stock or securities shall be increased as of the date of the initial transfer by the amount of the gain recognized.

(iii) *Other appropriate adjustments.* The basis of other stock, securities, or a partnership interest shall be increased, as appropriate, in accordance with the principles of this paragraph (c)(4). Under no circumstances shall the basis of stock, securities, or of a partnership interest held by a U.S. person that does not recognize gain under paragraph (c)(1)(i) of this section be increased under this paragraph (c)(4). In addition, under no circumstances shall the basis of any property be increased by the amount of any additional tax due or interest paid with respect to such tax, nor shall the basis of the assets of the transferred corporation be increased as a result of gain recognized by the U.S. transferor under paragraph (c)(1)(i) of this section.

(iv) *Cross-reference.* See paragraph (q)(2) of this section, *Examples 1*, *2*, *3*, and *5* for illustrations of the rules of this paragraph (c)(4). See also §1.367(a)–1T(b)(4) for rules that determine the increase to basis of property resulting from the application of section 367(a).

(5) *Terms and conditions of a new gain recognition agreement*—(i) *General rule.* A new gain recognition agreement entered into pursuant to this section shall replace the existing gain recognition agreement, which shall terminate without further effect. The term of the new gain recognition agreement shall be the remaining term of the existing gain recognition agreement. The amount of gain subject to the new gain recognition agreement shall equal the amount of gain subject to the existing gain recognition agreement, reduced by any gain recognized under paragraph (c)(1)(i) of this section with respect to the existing gain recognition agreement by reason of the gain recognition event that gives rise to the new gain recognition agreement. The new gain recognition agreement shall, as applicable, be subject to the conditions and requirements of this section to the

same extent as the existing gain recognition agreement. For example, a triggering event with respect to the new gain recognition agreement will generally include a disposition of the transferred stock or securities or of substantially all the assets of the transferred corporation. If, however, the transferred stock is canceled or redeemed pursuant to the disposition or other event that gives rise to the new gain recognition agreement (for example, pursuant to a liquidation where the transferee foreign corporation is the corporate distributee (within the meaning of section 334(b)(2)), or an asset reorganization where the transferee foreign corporation is the acquiring corporation) the transferred stock is not subject to the new gain recognition agreement.

(ii) *Special rule for inclusion of gain.* If the U.S. transferor with respect to the new gain recognition agreement is not the U.S. transferor with respect to the existing gain recognition agreement, or a member of the consolidated group of which the U.S. transferor with respect to the existing gain recognition agreement was a member on the date of the initial transfer, then any gain recognized under paragraph (c)(1)(i) of this section with respect to the new gain recognition agreement must be included in income in the taxable year during which the gain recognition event occurs.

(6) *Cross-reference.* For gain recognition agreements entered into pursuant to certain outbound asset reorganizations, see §1.367(a)–3(e)(6).

(d) *Filing requirements*—(1) *General rule.* An initial gain recognition agreement must be timely filed in order for the U.S. transferor to avoid recognizing gain under section 367(a)(1) with respect to the transferred stock or securities by reason of the applicable exceptions provided under §1.367(a)–3. Except as provided in paragraph (p) of this section, an initial gain recognition agreement is timely filed only if—

(i) The initial gain recognition agreement and any other gain recognition agreement document required to be filed with the initial gain recognition agreement are included with a timely filed return of the U.S. transferor for the taxable year during which the initial transfer occurs; and

(ii) Each gain recognition agreement document identified in paragraph (d)(1)(i) of this section is completed in all material respects.

(2) *Special requirements*—(i) *New gain recognition agreement.* A new gain recognition agreement entered into under this section must be included with the timely-filed return of the U.S. transferor (as identified in the new gain recognition agreement) for the taxable year during which the disposition or event that requires the new gain recognition agreement occurs. If the new gain recognition agreement is entered into by the U.S. transferor that entered into the existing gain recognition agreement, the new gain recognition agreement is in lieu of the annual certification otherwise required for such taxable year under paragraph (g) of this section with respect to the existing gain recognition agreement.

(ii) *Multiple events within a taxable year.* Except as otherwise provided in this paragraph (d)(2)(ii), if the initial transfer and one or more dispositions or other events (even if a triggering event exception applies) that affect the gain recognition agreement entered into by the U.S. transferor with respect to the initial transfer occur within the same taxable year of such U.S. transferor, or if multiple dispositions or other events occur in a taxable year of the U.S. transferor that does not include the initial transfer, only one gain recognition agreement is required to be entered into and included with the timely-filed return of the U.S. transferor for such taxable year. The gain recognition agreement must describe the initial transfer and/or each disposition or other event that affects the gain recognition agreement (even if a triggering event exception applies). This paragraph does not apply, however, if any such disposition or other event requires a new gain recognition agreement to be entered into by a United States person other than the U.S. transferor with respect to the initial transfer or that entered into the existing gain recognition agreement, as applicable.

(3) *Common parent as agent for U.S. transferor.* If the U.S. transferor is a

member but not the common parent of a consolidated group, the common parent of the consolidated group is the agent for the U.S. transferor under §1.1502–77(a)(1). Thus, the common parent must file the gain recognition agreement on behalf of the U.S. transferor. References in this section to the timely-filed return of the U.S. transferor include the timely-filed return of the consolidated group of which the U.S. transferor is a member, as applicable.

(e) *Signatory*—(1) *General rule.* The gain recognition agreement must be signed under penalties of perjury by an agent of the U.S. transferor that is authorized to sign under a general or specific power of attorney, or by the appropriate party based on the category of the U.S. transferor described in this paragraph (e)(1).

(i) If the U.S. transferor is a corporation but not a member of a consolidated group, a responsible officer of the U.S. transferor. If the U.S. transferor is a member of a consolidated group, a responsible officer of the common parent of the consolidated group.

(ii) If the U.S. transferor is an individual, the individual.

(iii) If the U.S. transferor is a trust or estate, a trustee, executor, or equivalent fiduciary of the U.S. transferor.

(iv) In a bankruptcy case under title 11, United States Code, a debtor in possession or trustee.

(2) *Signature requirement.* The inclusion of an unsigned copy of the gain recognition agreement with the timely-filed return of the U.S. transferor shall satisfy the signature requirement of paragraph (e)(1) of this section if the U.S. transferor retains the original signed gain recognition agreement in the manner specified by §1.6001–1(e).

(f) *Extension of period of limitations on assessments of tax*—(1) *General rule.* In connection with the filing of a gain recognition agreement, the U.S. transferor must extend the period of limitations on assessments of tax with respect to the gain realized but not recognized on the initial transfer through the close of the eighth full taxable year following the taxable year during which the initial transfer occurs. The U.S. transferor extends the period of limitations by filing Form 8838 ''Consent to Extend the Time to Assess Tax Under Section 367—Gain Recognition Agreement.'' The Form 8838 must be signed by a person authorized to sign the gain recognition agreement under paragraph (e)(1) of this section.

(2) *New gain recognition agreement.* If a new gain recognition agreement is entered into under this section, the U.S. transferor must extend the period of limitations on assessments of tax on the initial transfer through the close of the eighth full taxable year following the taxable year during which the initial transfer occurs, consistent with paragraph (f)(1) of this section, unless the U.S. transferor with respect to the new gain recognition agreement is the U.S. transferor with respect to the existing gain recognition agreement, or a member of the consolidated group of which the U.S. transferor with respect to the existing gain recognition agreement was a member on the date of the initial transfer.

(g) *Annual certification.* Except as provided in paragraph (d)(2)(i) of this section, the U.S. transferor must include with its timely-filed return for each of the five full taxable years following the taxable year of the initial transfer a certification (annual certification) that includes the information described in paragraphs (g)(1) through (3) of this section, as appropriate. The annual certification must be signed by a person authorized under paragraph (e)(1) of this section to sign the gain recognition agreement for the initial transfer. The inclusion of an unsigned copy of the annual certification with the relevant timely-filed return of the U.S. transferor shall satisfy the signature requirement of paragraph (e)(1) of this section provided the U.S. transferor retains the original signed certification in the manner specified by §1.6001–1(e).

(1) A statement of whether a gain recognition event has or has not occurred during such taxable year. If a gain recognition event has occurred during such taxable year, the annual certification must state:

(i) The amount of gain subject to the gain recognition agreement at the time of the gain recognition event;

(ii) The amount of gain recognized under the gain recognition agreement

by reason of the gain recognition event; and

(iii) A calculation of the reduction to the amount of gain subject to the gain recognition agreement by reason of the gain recognition event (for example, in the case of a gain recognition event described in paragraph (n)(2) of this section).

(2) A complete description of any event occurring during such taxable year that has terminated or reduced the amount of gain subject to the gain recognition agreement (for example, an event described in paragraph (o) of this section), including a calculation of any reduction to the amount of gain subject to the gain recognition agreement.

(3) A statement describing any disposition of assets of the transferred corporation during the taxable year not in the ordinary course of business.

(h) *Use of security.* The U.S. transferor may be required to furnish a bond or other security that satisfies the requirements of §301.7101–1 if the Area Director, Field Examination, Small Business/Self Employed or the Director of Field Operations, Large and Mid-Size Business (Director) determines that such security is necessary to ensure the payment of any tax on the gain realized, but not recognized, upon the initial transfer. Such bond or security generally will be required only if the transferred stock or securities are a principal asset of the U.S. transferor and the Director has reason to believe that a disposition of the stock or securities may be contemplated.

(i) [Reserved]

(j) *Triggering events.* Except as provided in this section, if an event described in paragraphs (j)(1) through (10) of this section (triggering event) occurs during the GRA term, the U.S. transferor must recognize gain under the gain recognition agreement in accordance with paragraph (c)(1)(i) of this section. This paragraph (j) generally requires the U.S. transferor to recognize gain (and pay applicable interest with respect to any additional tax due as provided in paragraph (c)(1)(v) of this section) under the gain recognition agreement to the extent the transferred stock or securities are disposed of, directly or indirectly. This paragraph (j) also requires the U.S. transferor to recognize gain under the gain recognition agreement in certain cases where it is not appropriate for the gain recognition agreement to continue. See paragraph (k) of this section for exceptions available for certain events that would otherwise constitute triggering events under this paragraph (j). See paragraph (o) of this section for certain events that terminate or reduce the amount of gain subject to a gain recognition agreement.

(1) *Disposition of transferred stock or securities.* A complete or partial disposition of the transferred stock or securities. See paragraph (q)(2) of this section, *Example 2* for an illustration of the rule of this paragraph (j)(1).

(2) *Disposition of substantially all of the assets of the transferred corporation*—(i) *General rule.* Except as provided in paragraph (j)(2)(ii) of this section, a disposition in one or more related transactions of substantially all of the assets of the transferred corporation (including stock or securities in a subsidiary corporation or a partnership interest). If the transferred corporation is domestic, see paragraph (o)(4) of this section.

(ii) *Exceptions.* For purposes of paragraph (j)(2)(i) of this section, the following dispositions shall be disregarded—

(A) Dispositions of property described in section 1221(a)(1) occurring in the ordinary course of business;

(B) An exchange of stock or securities described in section 354 that is pursuant to an asset reorganization; and

(C) An exchange of stock by a corporate distributee (as defined in section 334(b)(2)) pursuant to a complete liquidation to which section 332 applies.

(3) *Disposition of certain partnership interests.* If the initial transfer occurs by reason of the transfer of a partnership interest, a complete or partial disposition of such partnership interest. See section 367(a)(4) and §1.367(a)–1T(c)(3)(ii).

(4) *Disposition of stock of the transferee foreign corporation.* A complete or partial disposition of the stock of the transferee foreign corporation received by the U.S. transferor in the initial transfer. For purposes of this section, an individual U.S. transferor that loses

U.S. citizenship or ceases to be a lawful permanent resident of the United States (within the meaning of section 7701(b)(6)) shall be treated as disposing of all the stock of the transferee foreign corporation received in the initial transfer as of the date before the loss of such status.

(5) *Deconsolidation.* A U.S. transferor that is a member of a consolidated group ceases to be a member of the consolidated group, other than by reason of an acquisition of the assets of the U.S. transferor in a transaction to which section 381(a) applies, or by reason of the U.S. transferor joining another consolidated group as part of the same transaction.

(6) *Consolidation.* A U.S. transferor becomes a member of a consolidated group, including a U.S. transferor that is a member of a consolidated group and that becomes a member of another consolidated group.

(7) *Death of an individual; trust or estate ceases to exist.* A U.S. transferor that is an individual dies, or a U.S. transferor that is a trust or estate ceases to exist.

(8) *Failure to comply.* A U.S. transferor fails to comply in any material respect with any requirement of this section, or the terms of the gain recognition agreement as described in paragraph (c)(1) of this section. A failure to comply under this paragraph (j)(8) will extend the period of limitations on assessment of tax for the taxable year in which gain is required to be reported until the close of the third full taxable year ending after the date on which the U.S. transferor furnishes to the Director of Field Operations International, Large Business & International (or any successor to the roles and responsibilities of such person) (Director) the information that should have been provided under this section. Except as provided in paragraph (p) of this section, for purposes of this paragraph (j)(8), a failure to comply includes—

(i) If there is a gain recognition event in a taxable year, a failure to report gain or pay any additional tax or interest due under the terms of the gain recognition agreement; and

(ii) A failure to file a gain recognition agreement document, other than an initial gain recognition agreement or a document required to be filed with the initial gain recognition agreement. For this purpose, there is a failure to file a gain recognition agreement document if—

(A) The gain recognition agreement document is not timely filed as required under this section, or

(B) The gain recognition agreement document is not completed in all material respects.

(9) *Gain recognition agreement filed in connection with indirect stock transfers and certain triangular asset reorganizations.* With respect to a gain recognition agreement entered into in connection with an indirect stock transfer (as defined in §1.367(a)–3(d)), or a triangular asset reorganization described in §1.367(a)–3(e)(6)(iv), an indirect disposition of the transferred stock or securities. For example, in the case of an indirect stock transfer described in §1.367(a)–3(d)(1)(iii)(A), a complete or partial disposition of the stock of the acquiring corporation.

(10) *Gain recognition agreement filed pursuant to paragraph (k)(14) of this section.* In the case of a gain recognition agreement entered into pursuant to paragraph (k)(14) of this section, in addition to any disposition or other event described in paragraphs (j)(1) through (9) of this section,—

(i) Any disposition or other event identified as a triggering event in a new gain recognition agreement as required under paragraph (k)(14)(iii) of this section; and

(ii) Any disposition or other event that is inconsistent with the principles of paragraph (k) of this section including, for example, an indirect disposition of the transferred stock or securities.

(k) *Triggering event exceptions.* Notwithstanding paragraph (j) of this section, a disposition or other event described in paragraphs (k)(1) through (14) of this section shall not constitute a triggering event. This paragraph (k) generally provides exceptions for certain dispositions that constitute nonrecognition transactions but only if, immediately after the disposition, a U.S. transferor retains, as applicable, a

direct or indirect interest in the transferred stock or securities, or in the assets of the transferred corporation, and a new gain recognition agreement is entered into with respect to the initial transfer in accordance with this paragraph (k). Notwithstanding the application of this paragraph (k), if a gain recognition event described under paragraphs (m) and (n) of this section occurs during the GRA term the U.S. transferor may be required to recognize gain under the gain recognition agreement in accordance with paragraph (c)(1)(i) of this section. See paragraph (o) of this section which provides that, notwithstanding paragraph (j) of this section, certain dispositions or other events shall instead terminate or reduce the amount of gain subject to a gain recognition agreement.

(1) *Transfers of stock of the transferee foreign corporation to a corporation or partnership.* A disposition of stock of the transferee foreign corporation received in the initial transfer pursuant to an exchange to which section 351, 354 (but only in a reorganization described in section 368(a)(1)(B) that is not a triangular reorganization), 361 (but only in a divisive reorganization to which section 355 applies), or 721 applies, shall not constitute a triggering event if a new gain recognition agreement is entered into in accordance with paragraphs (k)(1)(i) through (iv) of this section, as applicable. In the case of an exchange to which section 354 applies that is pursuant to a triangular reorganization described in section 368(a)(1)(B), see paragraph (k)(14) of this section and paragraph (q)(2) of this section, *Example 4*.

(i) In the case of an exchange to which section 351 or 354 applies in which stock of a foreign acquiring corporation is received, the U.S. transferor includes with the new gain recognition agreement a statement that a complete or partial disposition of the stock of the foreign acquiring corporation received in the exchange shall constitute a triggering event. The principles of paragraph (o)(1)(i) or (ii), as appropriate, shall be applied to determine whether a subsequent complete or partial disposition of the stock of the foreign acquiring corporation received in the exchange shall instead terminate or reduce the amount of the new gain recognition agreement.

(ii) In the case of an exchange to which section 351 or 354 applies in which stock of a domestic acquiring corporation is received, the domestic acquiring corporation enters into the new gain recognition agreement, which must designate the domestic acquiring corporation as the U.S. transferor for purposes of this section. For an illustration of the rule provided by this paragraph (k)(1)(ii), see paragraph (q)(2) of this section, *Example 3*.

(iii) In the case of a section 361 exchange that is pursuant to a divisive reorganization to which section 355 applies and in which stock of a domestic corporation (domestic controlled corporation) is received, the domestic controlled corporation enters into the new gain recognition agreement, which must designate the domestic controlled corporation as the U.S. transferor for purposes of this section. For an illustration of the rule provided by this paragraph (k)(1)(iii), see paragraph (q)(2) of this section, *Example 11*.

(iv) In the case of an exchange to which section 721 applies, the U.S. transferor includes with the new gain recognition agreement a statement that a complete or partial disposition of the partnership interest received in the exchange shall constitute a triggering event for purposes of the new gain recognition agreement.

(2) *Complete liquidation of U.S. transferor under sections 332 and 337.* A distribution by the U.S. transferor of the stock of the transferee foreign corporation received in the initial transfer to which section 337 applies, that is pursuant to a complete liquidation under section 332, shall not constitute a triggering event if the corporate distributee (as defined in section 334(b)(2)) is a domestic corporation (domestic corporate distributee) and the domestic corporate distributee enters into a new gain recognition agreement. The new gain recognition agreement must designate the domestic corporate distributee as the U.S. transferor for purposes of this section.

(3) *Transfers of transferred stock or securities to a corporation or partnership.* A disposition of the transferred stock or securities pursuant to an exchange to

which section 351, 354 (but only in a reorganization described in section 368(a)(1)(B)), or 721 applies, shall not constitute a triggering event if the U.S. transferor enters in to a new gain recognition agreement that provides that the dispositions described in paragraphs (k)(3)(i) and (ii) of this section shall constitute triggering events for purposes of the new gain recognition agreement.

(i) A complete or partial disposition of the stock, securities, or partnership interest (as applicable) received in exchange for the transferred stock or securities.

(ii) Any other event that is inconsistent with the principles of this paragraph (k), including the indirect disposition of the transferred stock or securities.

(4) *Transfers of substantially all of the assets of the transferred corporation.* A disposition of substantially all of the assets of the transferred corporation pursuant to an exchange to which section 351, 354 (but only in a reorganization described in section 368(a)(1)(B)), or 721 applies, shall not constitute a triggering event if the U.S. transferor enters into a new gain recognition agreement that provides that a complete or partial disposition of the stock, securities, or partnership interest (as applicable) received in exchange for the assets shall constitute a triggering event for purposes of the new gain recognition agreement.

(5) *Recapitalizations and section 1036 exchanges.* A complete or partial disposition of the transferred stock or securities, or of the stock of the transferee foreign corporation received in the initial transfer, pursuant to a reorganization described under section 368(a)(1)(E), or pursuant to a transaction to which section 1036 applies, shall not constitute a triggering event if the U.S. transferor enters into a new gain recognition agreement.

(6) *Certain asset reorganizations*—(i) *Stock of transferee foreign corporation.* If stock of the transferee foreign corporation received in the initial transfer is transferred to a domestic acquiring corporation in a section 361 exchange that is pursuant to an asset reorganization, the exchanges made pursuant to the asset reorganization shall not constitute triggering events if the domestic acquiring corporation enters into a new gain recognition agreement that designates the domestic acquiring corporation as the U.S. transferor for purposes of this section. For an illustration of the rule provided by this paragraph (k)(6), see paragraph (q)(2) of this section, *Example 5.* If the acquiring corporation is foreign, see paragraph (k)(14) of this section and paragraph (q)(2) of this section, *Example 6.*

(ii) *Transferred stock or securities.* If the transferred stock or securities are transferred to a foreign acquiring corporation in a section 361 exchange that is pursuant to an asset reorganization, the exchanges made pursuant to the asset reorganization shall not constitute triggering events if the U.S. transferor enters into a new gain recognition agreement that designates the foreign acquiring corporation as the transferee foreign corporation for purposes of this section. For an illustration of the rule provided by this paragraph, see paragraph (q)(2) of this section, *Example 7.* If the transfer is to a domestic acquiring corporation, or is pursuant to a triangular asset reorganization, see paragraph (k)(14) or (o)(5) of this section.

(iii) *Assets of transferred corporation.* If substantially all of the assets of the transferred corporation are transferred to a foreign or domestic acquiring corporation in a section 361 exchange that is pursuant to an asset reorganization, the exchanges made pursuant to the asset reorganization shall not constitute triggering events if the U.S. transferor enters into a new gain recognition agreement that, unless the acquiring corporation is the transferee foreign corporation, designates the acquiring corporation as the transferred corporation for purposes of this section. Only the assets of the transferred corporation received by the acquiring corporation shall be treated as assets of the transferred corporation for purposes of this section (for example, only such assets will be taken into account for purposes of paragraph (j)(2) of this section). For an illustration of the rule provided by this paragraph, see paragraph (q)(2) of this section, *Example 8.* If the transferred corporation is domestic, see section 367(a)(1) and (a)(5), and

paragraph (o)(4) of this section. If the transfer is pursuant to a triangular asset reorganization, see paragraph (k)(14) of this section.

(7) *Certain triangular reorganizations*—(i) *Transferee foreign corporation.* If substantially all of the assets of the transferee foreign corporation are transferred to a foreign acquiring corporation in a section 361 exchange that is pursuant to a triangular asset reorganization, the exchanges made pursuant to the reorganization shall not constitute triggering events if a new gain recognition agreement is entered into in accordance with paragraphs (k)(7)(i)(A) through (C) of this section. If the acquiring corporation is domestic, see paragraph (k)(14) of this section. For rules that apply to gain recognition agreements entered into as a result of an indirect stock transfer, see §1.367(a)–3(d)(2)(iv) and paragraph (j)(9) of this section.

(A) If P is foreign, the new gain recognition agreement designates P as the transferee foreign corporation and includes a statement that the U.S. transferor agrees to treat a complete or partial disposition of the S stock held by P as a triggering event.

(B) Except as provided in paragraph (k)(7)(i)(C) of this section, if P is domestic, P enters into the new gain recognition agreement that designates P as the U.S. transferor and S as the transferee foreign corporation.

(C) If the triangular asset reorganization is described in section 368(a)(1)(A) by reason of section 368(a)(2)(E) and the transferee foreign corporation is the merged corporation, the U.S. transferor enters into the new gain recognition agreement and designates the surviving corporation as the transferee foreign corporation.

(ii) *Transferred corporation.* If substantially all of the assets of the transferred corporation are transferred in a section 361 exchange pursuant to a triangular asset reorganization, the exchanges made pursuant to the reorganization shall not constitute triggering events if the U.S. transferor enters into a new gain recognition agreement in accordance with paragraph (k)(7)(ii)(A) of this section and, as applicable, paragraph (k)(7)(ii)(B) or (C) of this section.

(A) The new gain recognition agreement includes a statement that the U.S. transferor agrees to treat a complete or partial disposition of the P stock received in the reorganization as a triggering event.

(B) If the triangular asset reorganization is described in section 368(a)(1)(C), or section 368(a)(1)(A) or (G) by reason of section 368(a)(2)(D), the new gain recognition agreement includes a statement that the U.S. transferor agrees to treat a complete or partial disposition of the S stock held by P as a triggering event.

(C) If the triangular asset reorganization is described in section 368(a)(1)(A) by reason of section 368(a)(2)(E) and the transferred corporation is the merged corporation, the new gain recognition agreement includes a statement that the U.S. transferor agrees to treat a complete or partial disposition of the stock of the surviving corporation as a triggering event.

(8) *Complete liquidation of transferred corporation.* A distribution of substantially all of the assets of the transferred corporation to which section 337 applies, and the related exchange of the transferred stock to which section 332 applies, shall not constitute triggering events, if the U.S. transferor enters into a new gain recognition agreement. If the transferred corporation is domestic, see §1.367(e)–2 and paragraph (o)(4) of this section. See paragraph (q)(2) of this section, *Example 9* for an illustration of the rules provided in this paragraph (k)(8).

(9) *Death of U.S. transferor.* The death of a U.S. transferor shall not constitute a triggering event if the person winding up the affairs of the U.S. transferor—

(i) Retains sufficient assets of the U.S. transferor to satisfy any possible Federal tax liability of the U.S. transferor under the gain recognition agreement for the duration of the extended period of limitations on assessments of tax on the gain realized but not recognized in the initial transfer;

(ii) Provides security as required under paragraph (h) of this section for any possible Federal tax liability of the U.S. transferor under the gain recognition agreement; or

(iii) Obtains a ruling from the Internal Revenue Service providing for one or more successors to the U.S. transferor under the gain recognition agreement.

(10) *Deconsolidation.* A deconsolidation of the U.S. transferor shall not constitute a triggering event if the U.S. transferor enters into a new gain recognition agreement.

(11) *Consolidation.* A consolidation of the U.S. transferor shall not constitute a triggering event if the U.S. transferor enters into a new gain recognition agreement. See paragraph (d)(3) of this section.

(12) *Intercompany transactions*—(i) *General rule.* If, pursuant to an intercompany transaction, the U.S. transferor disposes of stock of the transferee foreign corporation received in the initial transfer, this paragraph (k)(12) applies to such disposition to the extent the intercompany transaction creates an intercompany item that is not taken into account in the taxable year during which the intercompany transaction occurs. To the extent this paragraph (k)(12) applies, the disposition shall not constitute a triggering event, and the U.S. transferor shall remain subject to the gain recognition agreement if the conditions of paragraphs (k)(12)(i)(A) and (B) of this section are satisfied. To the extent the intercompany transaction does not create an intercompany item see, for example, paragraph (k)(1) and paragraph (q)(2) of this section, *Example 20.* See paragraph (o)(6) of this section for the effect on a gain recognition agreement when an intercompany item from an intercompany transaction to which this paragraph (k)(12)(i) applies is taken into account.

(A) At the time of the disposition, the basis of the stock of the transferee foreign corporation received in the initial transfer that is disposed of in the intercompany transaction is not greater than the sum of the amounts described in paragraphs (k)(12)(i)(A)(*1*) through (*3*) of this section. If only a portion of the stock of the transferee foreign corporation received in the initial transfer is disposed of, then the basis of such stock shall be compared with a proportionate amount (measured by value as determined at the time of the disposition) of the amounts described in paragraph (k)(12)(i)(A)(*1*) through (*3*) of this section. To satisfy the basis condition of this paragraph (k)(12)(i)(A), the U.S. transferor may reduce the basis of the stock of the transferee foreign corporation received in the initial transfer that is disposed of in the intercompany transaction in accordance with the principles of paragraph (o)(1)(iii) of this section.

(*1*) The aggregate basis of the transferred stock or securities at the time of the initial transfer;

(*2*) The amount of any increase to the basis of the transferred stock or securities by reason of gain recognized by the U.S. transferor on the initial transfer; and

(*3*) The amount of any increase to the basis of the stock disposed of by reason of an income inclusion by the U.S. transferor with respect to such stock (for example, pursuant to section 961(a)).

(B) The annual certification filed with respect to the existing gain recognition agreement for the taxable year during which the intercompany transaction occurs includes a complete description of the intercompany transaction and a schedule illustrating how the basis condition of paragraph (k)(12)(i)(A) of this section is satisfied.

(ii) *Certain dispositions following intercompany transaction.* A subsequent disposition of stock of the transferee foreign corporation that is transferred in an intercompany transaction to which the exception provided by paragraph (k)(12)(i) of this section applies shall not constitute a triggering event if—

(A) The stock is transferred to a member of the consolidated group that includes the U.S. transferor immediately after the disposition, and

(B) The annual certification filed with respect to the existing gain recognition agreement for the taxable year during which the subsequent disposition occurs includes a complete description of the disposition.

(13) *Deemed asset sales pursuant to section 338(g) elections.* A deemed sale of the assets of the transferred corporation or the transferee foreign corporation as a result of an election under section 338(g) shall not constitute a triggering event. This paragraph does

not apply to the sale of the stock of the target corporation (within the meaning of section 338(d)(2)) with respect to which such election is made.

(14) *Other dispositions or events.* A disposition or other event that would constitute a triggering event, without regard to this paragraph (k)(14), shall not constitute a triggering event if the conditions of paragraph (k)(14)(i) through (iii) of this section, as applicable, are satisfied. See paragraph (q)(2), *Examples 4*, *6*, *10*, *12*, *17*, *21*, and *23* of this section for illustrations of the rules provided by this paragraph (k)(14).

(i) The disposition qualifies as a nonrecognition transaction.

(ii) Immediately after the disposition or other event, a U.S. transferor retains a direct or indirect interest in the transferred stock or securities or, as applicable, in substantially all of the assets of the transferred corporation (for example, in a case where the transferred corporation has been liquidated pursuant to section 332). If, as a result of the disposition or other event, a foreign corporation acquires the transferred stock or securities or, as applicable, substantially all the assets of the transferred corporation, the condition of this paragraph (k)(14)(ii) shall be satisfied only if the U.S. transferor owns at least five percent (applying the attribution rules of section 318, as modified by section 958(b)) of the total voting power and the total value of the outstanding stock of such foreign corporation.

(iii) A new gain recognition agreement is entered into by the U.S. transferor described in paragraph (k)(14)(ii) of this section that includes—

(A) An explanation of why this paragraph (k)(14) applies to the disposition or other event; and

(B) A description of each subsequent disposition or other event that would constitute a triggering event, other than those described in paragraph (j) of this section, with respect to the new gain recognition agreement based on the principles of paragraphs (j) and (k) of this section including, for example, an indirect disposition of the transferred stock or securities.

(l) [Reserved]

(m) *Receipt of boot in nonrecognition transactions*—(1) *Dispositions of transferred stock or securities.* Notwithstanding paragraph (k) of this section, if gain is required to be recognized (not including any gain that would be treated as a dividend under section 356(a)(2)) in connection with a disposition of the transferred stock or securities to which an exception under paragraph (k) of this section otherwise applies (triggering event exception), the U.S. transferor shall recognize gain under paragraph (c)(1)(i) of this section equal to the amount of gain required to be recognized in connection with the disposition, but not in excess of the amount of gain subject to the gain recognition agreement. For purposes of this paragraph (m)(1), the amount of gain required to be recognized in connection with the disposition shall be determined before taking into account any increase to the basis of the transferred stock or securities under paragraph (c)(4)(ii) of this section. See paragraph (q)(2) of this section, *Example 13*, for an illustration of the rule provided by this paragraph (m)(1).

(2) *Dispositions of assets of transferred corporation.* If gain is required to be recognized (not including any gain that would be treated as a dividend under section 356(a)(2)) in connection with a disposition of substantially all of the assets of the transferred corporation to which a triggering event exception otherwise applies, the U.S. transferor shall recognize gain under paragraph (c)(1)(i) of this section equal to the amount of gain required to be recognized in connection with the disposition, but not in excess of the amount of gain subject to the gain recognition agreement.

(n) *Special rules for distributions with respect to stock*—(1) *Certain dividend equivalent redemptions treated as dispositions.* A redemption of the transferred stock or of stock of the transferee foreign corporation received in the initial transfer that is treated by reason of section 302(d) as a distribution of property to which section 301 applies shall constitute a disposition for purposes of this section unless the U.S. transferor enters into a new gain recognition agreement that includes appropriate provisions to account for the redemption. For an illustration of the rule of this paragraph (n)(1), see paragraph (q)(2) of this section, *Example 14*.

(2) *Gain recognized under section 301(c)(3).* If gain is required to be recognized under section 301(c)(3) with respect to the transferred stock, the U.S. transferor shall recognize gain under the gain recognition agreement in accordance with paragraph (c)(1)(i) of this section in an amount equal to the gain required to be recognized under section 301(c)(3), but not in excess of the amount of gain subject to the gain recognition agreement. For this purpose, the amount of gain required to be recognized under section 301(c)(3) shall be determined before taking into account any increase in the basis of the transferred stock under paragraph (c)(4)(ii) of this section.

(o) *Dispositions or other events that terminate or reduce the amount of gain subject to the gain recognition agreement.* Notwithstanding paragraph (j) of this section, the following dispositions or other events shall not constitute triggering events but instead shall terminate or reduce the amount of gain subject to the gain recognition agreement.

(1) *Taxable disposition of stock of the transferee foreign corporation*—(i) *Complete disposition.* Except as otherwise provided in this paragraph (o)(1)(i), if the U.S. transferor disposes of all the stock of the transferee foreign corporation received in the initial transfer in a transaction in which all gain realized is recognized and included in taxable income during the taxable year of the disposition, the gain recognition agreement shall terminate without further effect if, at the time of the disposition, the aggregate basis of such stock is not greater than the sum of the amounts described in paragraphs (o)(1)(i)(A) through (C) of this section. This paragraph shall not apply to a disposition of stock of the transferee foreign corporation pursuant to an intercompany transaction to which paragraph (k)(12) of this section applies. This paragraph shall also not apply to an individual U.S. transferor that loses U.S. citizenship or ceases to be a lawful permanent resident of the United States (within the meaning of section 7701(b)(6)).

(A) The aggregate basis of the transferred stock or securities at the time of the initial transfer;

(B) The amount of any increase to the basis of the transferred stock or securities by reason of gain recognized by the U.S. transferor on the initial transfer; and

(C) The amount of any increase to the basis of the stock disposed of by reason of an income inclusion by the U.S. transferor with respect to such stock (for example, pursuant to section 961(a)).

(ii) *Partial dispositions.* A partial disposition by the U.S. transferor of the stock of the transferee foreign corporation received in the initial transfer in a transaction otherwise described in paragraph (o)(1)(i) of this section shall reduce the amount of gain subject to the gain recognition agreement based on the relative fair market value of the stock disposed of (measured at the time of the disposition) compared to the fair market value of all of the stock of the transferee foreign corporation received in the initial transfer (measured at the time of the disposition). For determining whether the basis condition of paragraph (o)(1)(i) of this section is satisfied in the case of a partial disposition, the aggregate basis of the stock disposed of is compared to a proportionate amount (based on fair market value, as measured at the time of the partial disposition) of the amounts described in paragraphs (o)(1)(i)(A) through (C) of this section. For an illustration of the rules of this paragraph (o)(1)(ii), see paragraph (q)(2), *Example 15,* of this section.

(iii) *Reduction of stock basis.* For purposes of satisfying the basis condition of paragraph (o)(1)(i) or (ii) of this section, the U.S. transferor may reduce the aggregate basis of the stock of the transferee foreign corporation received in the initial transfer, effective immediately before the disposition. For an illustration of the rules of this paragraph (o)(1)(iii), see paragraph (q)(2), *Example 16,* of this section. The U.S. transferor reduces the basis of the stock of the transferee foreign corporation by including a statement with the timely-filed return of the U.S. transferor for the taxable year in which the disposition occurs, entitled ''Election to Reduce Stock Basis Under § 1.367(a)–8(o)(1)(iii)'' and that includes—

(A) A description, including the date, of the disposition;

(B) A description of the stock of the transferee foreign corporation disposed of and the basis adjustments made under this paragraph (o)(1)(iii); and

(C) The fair market value of all the stock of the transferee foreign corporation held by the U.S. transferor at the time of the disposition.

(2) *Gain recognized in connection with certain nonrecognition transactions.* If the U.S. transferor recognizes gain in connection with a complete or partial disposition of stock of the transferee foreign corporation received in the initial transfer that is described in paragraph (k) of this section, and the basis condition of paragraph (o)(1)(i) or (ii) of this section, as applicable, is satisfied with the respect to such disposition, the amount of gain subject to the new gain recognition agreement filed under paragraph (k) of this section as a result of such disposition shall equal the amount of gain subject to the existing gain recognition agreement reduced by the amount of gain recognized by the U.S. transferor on the disposition. If the U.S. transferor recognizes gain in connection with a complete or partial disposition of the stock of the transferee foreign corporation received in the initial transfer that is described in paragraph (k) of this section, and the condition of paragraph (o)(1)(i) or (ii) of this section, as applicable, is satisfied with the respect to the disposition, but a new gain recognition agreement is not filed with respect to such disposition so that a triggering event exception does not apply to the disposition, the amount of gain required to be recognized by the U.S. transferor under the existing gain recognition agreement shall be reduced by the amount of the gain recognized on the disposition.

(3) *Gain recognized under section 301(c)(3).* If the U.S. transferor recognizes gain under section 301(c)(3) with respect to the stock of the transferee foreign corporation received in the initial transfer, the amount of gain subject to the gain recognition agreement shall be reduced by the amount of such recognized gain.

(4) *Dispositions of substantially all of the assets of a domestic transferred corporation.* Except as otherwise provided in this paragraph (o)(4), the gain recognition agreement shall terminate without further effect if substantially all of the assets of the transferred corporation are disposed of in a transaction in which all gain realized is recognized and included in taxable income during the taxable year of the disposition, but only if, at the time of the initial transfer, the U.S. transferor owned stock in the transferred corporation satisfying the requirements of section 1504(a)(2) and the U.S. transferor and the transferred corporation were members of the same consolidated group. If the initial transfer was part of an indirect stock transfer, the gain recognition agreement shall terminate without further effect if substantially all of the assets of the transferred corporation (taking into account §1.367(a)–3(d)(2)(v)) are disposed of in a transaction in which all gain realized is recognized and included in taxable income during the taxable year of the disposition, but only if at the time of the initial transfer the U.S. transferor owned stock in the transferred corporation satisfying the requirements of section 1504(a)(2) (for example, in the case of a reorganization described in section 368(a)(1)(A) by reason of section 368(a)(2)(E)) and the U.S. transferor and the transferred corporation were members of the same consolidated group.

(5) *Certain distributions or transfers of transferred stock or securities to U.S. persons.* To the extent a distribution or transfer of the transferred stock or securities satisfies the conditions of paragraphs (o)(5)(i) through (iii) of this section, the gain recognition agreement shall terminate without further effect, or the amount of gain subject to the gain recognition agreement shall be reduced, as appropriate.

(i) *Distributions or transfers described in section 337, 355, or 361.* The transferred stock or securities are distributed or transferred pursuant to a transaction described in paragraph (o)(5)(i)(A) through (D) of this section, as appropriate.

(A) A distribution described in section 337 that is pursuant to a complete liquidation described in section 332. See paragraph (q)(2) of this section, *Example 18,* for an illustration of the rule provided by this paragraph (o)(5)(i)(A).

(B) A distribution to which section 355 applies. See paragraph (q)(2) of this

section, *Example 19*, for an illustration of the rule provided by this paragraph (o)(5)(i)(B).

(C) A section 361 exchange that is pursuant to an asset reorganization. See paragraph (q)(2) of this section, *Example 22*, for an illustration of the rule provided by this paragraph (o)(5)(i)(C).

(D) A distribution to which section 361(c) applies that is pursuant to an asset reorganization. See paragraph (q)(2) of this section, *Example 22*, for an illustration of the rule provided by this paragraph (o)(5)(i)(D).

(ii) *Qualified recipient.* The recipient of the transferred stock or securities in the relevant transaction described in paragraph (o)(5)(i) of this section (qualified recipient) is—

(A) The U.S. transferor;

(B) A member of the consolidated group that includes the U.S. transferor immediately after the transaction; or

(C) An individual that is a United States person.

(iii) *Basis requirement*—(A) *General rule.* Immediately after the relevant transaction described in paragraph (o)(5)(i) of this section, the aggregate basis of the transferred stock or securities received by the qualified recipient is not greater than the aggregate basis of such stock or securities at the time of the initial transfer (as adjusted for gain recognized by the U.S. transferor on the initial transfer attributable to such stock or securities). For this purpose, the basis of the transferred stock in the hands of the qualified recipient shall be determined without regard to any basis attributable to income inclusions with respect to the stock (for example, under section 961(a)). In the case of a distribution to which section 355 applies, any adjustments to basis under §1.367(b)–5(c) shall be made before determining whether the basis condition of this paragraph is satisfied.

(B) *Election to reduce basis in transferred stock or securities.* If the basis condition of paragraph (o)(5)(iii)(A) of this section is not satisfied, each qualified recipient may reduce the basis of the transferred stock or securities received in the transaction to the extent necessary to satisfy the basis condition. A qualified recipient reduces the basis of the transferred stock or securities by including a statement with its timely-filed return for the taxable year during which the distribution or transfer occurs entitled ''Election to Reduce Stock Basis Under §1.367(a)–8(o)(5)(iii)(B)'' and that includes—

(*1*) A complete description and the date of the distribution or transfer;

(*2*) The fair market value of the transferred stock or securities received by the qualified recipient in the transaction; and

(*3*) The basis of the transferred stock or securities received by the qualified recipient immediately before and after the basis reduction.

(6) *Dispositions or other event following certain intercompany transactions.* If, subsequent to an intercompany transaction to which paragraph (k)(12) of this section applies, a disposition or other event occurs that requires the U.S. transferor to take into account the intercompany item related to the intercompany transaction (under the provisions of §1.1502–13), the gain recognition agreement shall terminate without further effect or the amount of gain subject to the gain recognition agreement shall be reduced based on the principles of paragraph (o)(1)(i) or (ii) of this section, as appropriate. For an illustration of the rules of this paragraph (o)(6), see paragraph (q)(2) of this section, *Example 20*.

(7) *Expropriations under foreign law.* The amount of gain subject to the gain recognition agreement shall be reduced to the extent the stock or securities of the transferee foreign corporation received in the initial transfer, the transferred stock or securities, or substantially all the assets of the transferred corporation, are expropriated, seized, or subjected to a similar taking of such property by the government of a foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing. Principles similar to those of paragraph (o)(1)(i) or (o)(1)(ii) of this paragraph, as relevant, shall be applied to determine the amount of the reduction.

(p) *Relief for certain failures to file or failures to comply that are not willful*—(1) *In general.* This paragraph (p) provides relief if there is a failure to file an initial gain recognition agreement as required under paragraph (d)(1) of this section (failure to file), or a failure to

comply that is a triggering event under paragraph (j)(8) of this section (failure to comply). A failure to file or failure to comply will be deemed not to have occurred for purposes of paragraph (d)(1) of this section or paragraph (j)(8) of this section if the U.S. transferor demonstrates that the failure was not willful using the procedure set forth in this paragraph (p). For this purpose, willful is to be interpreted consistent with the meaning of that term in the context of other civil penalties, which would include a failure due to gross negligence, reckless disregard, or willful neglect. Whether a failure to file or failure to comply was willful will be determined by the Director (as described in paragraph (j)(8) of this section) based on all the facts and circumstances. The U.S. transferor must submit a request for relief and an explanation as provided in paragraph (p)(2)(i) of this section. Although a U.S. transferor whose failure to file or failure to comply is determined not to be willful will not be subject to gain recognition under paragraph (b), (c), or (e) of §1.367(a)–3 or paragraph (c)(1) of this section, as applicable, the U.S. transferor will be subject to a penalty under section 6038B if the U.S. transferor fails to satisfy the reporting requirements under that section and does not demonstrate that the failure was due to reasonable cause and not willful neglect. See §1.6038B–1(b)(2) and (f). The determination of whether the failure to file or failure to comply was willful under this section has no effect on any request for relief made under §1.6038B–1(f).

(2) *Procedures for establishing that a failure to file or failure to comply was not willful*—(i) *Time and manner of submission.* A U.S. transferor's statement that a failure to file or failure to comply was not willful will be considered only if, promptly after the U.S. transferor becomes aware of the failure, an amended return is filed for the taxable year to which the failure relates that includes the information that should have been included with the original return for such taxable year or that otherwise complies with the rules of this section, and that includes a written statement explaining the reasons for the failure to file or failure to comply. The U.S. transferor must file, with the amended return, a Form 8838 extending the period of limitations on assessment of tax with respect to the gain realized but not recognized on the initial transfer to the later of: The close of the eighth full taxable year following the taxable year during which the initial transfer occurred (date one); or the close of the third full taxable year ending after the date on which the required information is provided to the Director (date two). However, the U.S. transferor is not required to file a Form 8838 with the amended return if both date one is later than date two and a Form 8838 was previously filed extending the period of limitations on assessment of tax with respect to the gain realized but not recognized on the initial transfer to date one. If a Form 8838 is not required to be filed with the amended return pursuant to the previous sentence, a copy of the previously filed Form 8838 must be filed with the amended return. The amended return and either a Form 8838 or a copy of the previously filed Form 8838, as the case may be, must be filed with the Internal Revenue Service at the location where the U.S. transferor filed its original return. The U.S. transferor may submit a request for relief from the penalty under section 6038B as part of the same submission. See §1.6038B–1(f).

(ii) *Notice requirement.* In addition to the requirements of paragraph (p)(2)(i) of this section, the U.S. transferor must comply with the notice requirements of this paragraph (p)(2)(ii). If any taxable year of the U.S. transferor is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Internal Revenue Service personnel conducting the examination. If no taxable year of the U.S. transferor is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Director.

(3) *Examples.* The following examples illustrate the application of this paragraph (p). All of the examples are based solely on the following facts and any

additional facts stated in the particular example. DC, a domestic corporation, wholly owns FS and FA, each a foreign corporation. In Year 1, pursuant to a transaction qualifying both as an exchange under section 351 and a reorganization under section 368(a)(1)(B), DC transferred all the FS stock to FA solely in exchange for voting stock of FA (FS Transfer). The fair market value of the FS stock exceeded DC's tax basis in the stock at the time of the FS transfer. Absent the application of section 367 to the transaction, DC's exchange of the FS stock for the stock of FA qualified as a tax-free exchange under sections 351(a) and section 354. Immediately after the transaction, both FA and FS were controlled foreign corporations (as defined in section 957). Furthermore, DC was a section 1248 shareholder (as defined in §1.367(b)–2(b)) with respect to FA and FS, and a 5-percent shareholder with respect to FA for purposes of §1.367(a)–3(b)(ii). Thus, DC was required to recognize gain under section 367(a)(1) by reason of the FS Transfer unless DC timely filed an initial gain recognition agreement (GRA) as required by paragraph (d)(1) of this section and complies in all material respects with the requirements of this section throughout the term of the GRA. The application of section 6038B is not addressed in these examples. DC may be subject to a penalty under section 6038B even if DC demonstrates under this section that a failure to file or failure to comply was not willful. See §1.6038B–1(b) and (f) for the application of section 6038B.

Example 1. Taxpayer failed to file a GRA due to accidental oversight. (i) *Facts.* DC filed its tax return for the year of the FS Transfer, reporting no gain with respect to the exchange of the FS stock. DC, through its tax department, was aware of the requirement to file a GRA in order for DC to avoid recognizing gain with respect to the FS Transfer under section 367(a)(1), and had the experience and competency to properly prepare the GRA. DC had filed many GRAs over the years and had never failed to timely file a GRA. However, although DC prepared the GRA with respect to the FS Transfer, it was not filed with DC's tax return for the year of the FS Transfer due to an accidental oversight. During the preparation of the following year's tax return, DC discovered that the GRA was not filed. DC filed an amended return to file the GRA and complied with the procedures set forth under paragraph (p)(2) of this section promptly after it became aware of the failure.

(ii) *Result.* Because DC failed to file a GRA with its timely filed tax return for the year of the FS Transfer, there is a failure to timely file the GRA as required by paragraph (d)(1) of this section. However, based on the facts of this *Example 1*, including that the failure to timely file the GRA was an isolated and accidental oversight, the failure to timely file is not a willful failure to file. Accordingly, the timely filed requirement of paragraph (d)(1) of this section is considered to be satisfied, and DC is not required to recognize the gain realized on the FS Transfer under section 367(a)(1).

Example 2. Taxpayer's course of conduct is taken into account in determination. (i) *Facts.* DC filed its tax return for the year of the FS Transfer, reporting no gain with respect to the exchange of the FS stock, but failed to file a GRA. DC, through its tax department, was aware of the requirement to file a GRA in order for DC to avoid recognizing gain with respect to the FS Transfer under section 367(a)(1). DC had not consistently and in a timely manner filed GRAs in the past, and also had an established history of failing to timely file other tax and information returns for which it was subject to penalties. In a year subsequent to Year 1, DC transferred stock of another foreign subsidiary with respect to which DC had a built-in gain (FS2) to FA in a transaction that qualified as both a reorganization under section 368(a)(1)(B) and an exchange described under section 351 (FS2 Transfer). DC was required to recognize gain on the FS2 Transfer under section 367(a)(1) unless DC timely filed a GRA as required by paragraph (d)(1) of this section and complied with the requirements of this section during the term of the GRA. DC reported no gain on the FS2 Transfer on its tax return, but failed to file a GRA. At the time of the FS2 Transfer, DC was already aware of its failure to file the GRA required for the prior FS Transfer, but had not implemented any safeguards to ensure that it would timely file GRAs for future transactions. DC filed an amended return to file the GRA for the FS2 Transfer and complied with the procedures set forth under paragraph (p)(2) of this section promptly after it became aware of the failure. DC asserts that its failure to timely file a GRA with respect to the FS2 Transfer was due to an isolated oversight similar to the one that occurred with respect to the FS Transfer. At issue is DC's failure to timely file a GRA for the FS2 Transfer.

(ii) *Result.* Because DC failed to file a GRA with its timely filed tax return for the year of the FS2 Transfer, there is a failure to timely file the GRA as required by paragraph (d)(1) of this section. DC's course of conduct is taken into account in determining whether its failure to timely file a GRA for the

FS2 Transfer was willful. Based on the facts of this *Example 2,* including DC's history of failing to file required tax and information returns in general and GRAs in particular, and its failure to implement safeguards to ensure that it would timely file GRAs, the failure to timely file a GRA with respect to the FS2 Transfer rises to the level of a willful failure to timely file. Accordingly, DC is ineligible for relief under paragraph (p) of this section, the GRA is not considered timely filed for purposes of paragraph (d)(1) of this section, and DC must recognize the full amount of the gain realized on the FS2 Transfer.

Example 3. GRA not completed in all material respects. (i) *Facts.* DC timely filed its tax return for the year of the FS Transfer, reporting no gain with respect to the exchange of the FS stock. DC was aware of the requirement to file a GRA to avoid recognizing gain under section 367(a)(1), including the requirement to provide the basis and fair market value of the transferred stock. However, DC filed a purported GRA that did not contain the fair market value of the FS stock. Instead, the GRA was filed with the statement that the fair market value information was ''available upon request.'' Other than the omission of the fair market value of the FS stock, the GRA contained all other information required by this section.

(ii) *Result.* Because DC omitted the fair market value of the FS stock from the GRA, the GRA was not completed in all material respects. Accordingly, there is a failure to timely file the GRA. Furthermore, because DC knowingly omitted such information, DC's omission is a willful failure to timely file a GRA. Accordingly, DC is ineligible for relief under paragraph (p) of this section, the GRA is not considered timely filed for purposes of paragraph (d)(1) of this section, and DC must recognize the full amount of the gain realized on the FS Transfer. The same result would arise if DC had included the fair market value of the FS stock, but knowingly omitted its tax basis from the GRA.

Example 4. Taxpayer knew of GRA filing requirement, but intentionally chose not to file. (i) *Facts.* When DC filed its tax return for the tax year of the FS Transfer, it was aware of the requirement to file a GRA to avoid recognizing gain under section 367(a)(1). However, because DC anticipated selling Business A in the following tax year, which was expected to produce a capital loss that could be carried back to fully offset the gain recognized on the FS Transfer, DC intentionally chose not to file a GRA. DC recognized the gain from the FS Transfer under section 367(a)(1) and reported the gain on its timely filed tax return. At the end of the following year, a large class action lawsuit was filed against Business A and, consequently, DC was unable to sell the business. As a result, DC did not realize the expected capital loss, and it was not able to offset the gain from the FS Transfer. DC now seeks to file a GRA for the FS Transfer.

(ii) *Result.* Because DC failed to file a GRA with its timely filed tax return for the year of the FS Transfer, there is a failure to timely file the GRA as required by paragraph (d)(1) of this section. Furthermore, because DC intentionally chose not to file a GRA for the FS Transfer, its actions constitute a willful failure to timely file a GRA. Accordingly, DC is ineligible for relief under paragraph (p) of this section, the GRA is not considered timely filed for purposes of paragraph (d)(1) of this section, and DC must recognize the full amount of the gain realized on the FS Transfer in Year 1.

(q) *Examples*—(1) *Presumed facts and references.* For purposes of the examples in paragraph (q)(2) of this section, and except where otherwise indicated, the following is presumed.

(i) UST, USP, and DC are domestic corporations that each use a calendar taxable year.

(ii) USP wholly owns UST and is the common parent of the consolidated group of which UST is a member.

(iii) TFC, TFD, F1, and FA are foreign corporations.

(iv) UST wholly owns TFD.

(v) In a section 351 exchange, UST transfers all of the stock of TFD (TFD stock) to TFC in exchange solely for stock of TFC (the initial transfer).

(vi) Pursuant to §1.367(a)–3(b)(1)(ii) and this section, UST enters into a gain recognition agreement in connection with the initial transfer and makes the election described under paragraph (c)(2)(vi) of this section with respect to the gain recognition agreement.

(vii) As applicable, the section 1248 amount (within the meaning of §1.367(b)–2(c)) or all earnings and profits amount (within the meaning of §1.367(b)–2(d)) attributable to the stock of a foreign corporation is zero.

(viii) All transactions are respected under general principles of tax law, including the step transaction doctrine.

(ix) References to a U.S. transferor entering into a gain recognition agreement mean, where applicable, that the common parent of the consolidated group of which the U.S. transferor is a member has filed the gain recognition agreement on behalf of the U.S. transferor in accordance with paragraph (d)(3) of this section.

(x) Taxable years during the GRA term are referred to, for example, as year 1 and year 2.

(2) *Examples.* The following examples illustrate the application of the rules of this section.

Example 1. Basis adjustments from gain recognized under the gain recognition agreement. (i) *Facts.* TFC wholly owns F1. In year 3, pursuant to a section 351 exchange, TFC transfers all of the TFD stock to F1 in exchange solely for voting stock of F1. UST enters into a new gain recognition agreement with respect to the initial transfer under paragraph (k)(3) of this section, and therefore the transfer by TFC of the TFD stock to F1 is not a triggering event. Under paragraph (c)(5)(i) of this section, the existing gain recognition agreement terminates without further effect. In year 4, in an exchange to which section 721 applies, UST contributes the TFC stock received in the initial transfer to PRS, a domestic partnership, in exchange for a partnership interest. UST enters into a new gain recognition agreement with respect to the initial transfer under paragraph (k)(1) of this section, and therefore the transfer by UST of the TFC stock to PRS is not a triggering event. Under paragraph (c)(5)(i) of this section, the new gain recognition agreement filed by UST in year 3 terminates without further effect. In year 5, TFD disposes of substantially all of its assets in a transaction that constitutes a triggering event under paragraph (j)(2)(i) of this section. Under paragraph (c)(1)(i) of this section, UST recognizes the gain realized but not recognized on the initial transfer by reason of entering into the gain recognition agreement.

(ii) *Result.* Under paragraph (c)(4) of this section, the basis of the PRS interest held by UST, the TFC stock held by PRS that was received from UST in year 4, the F1 stock held by TFC that was received in exchange for the TFD stock in year 3, and the TFD stock held by F1 that was received from TFC in year 3 is increased by the amount of gain recognized by UST (but not by the additional tax or interest paid as result of such gain) with respect to the initial transfer under the gain recognition agreement. However, the basis of the assets of TFD (including the assets disposed of in year 5) is not increased as a result of the gain recognized by UST.

Example 2. Impact of gain recognition event on computation of income. (i) *Facts.* At the time of the initial transfer, the TFD stock has a $50x basis, a $100x fair market value, and a $30x section 1248 amount. The amount of gain subject to the gain recognition agreement is $50x. UST did not make an election under paragraph (c)(2)(vi) of this section with respect to the gain recognition agreement. In year 3, TFC disposes of the TFD stock received in the initial transfer in exchange for $120x cash.

(ii) *Result*—(A) *Gain recognition without an election.* The disposition by TFC of the TFD stock in year 3 is a triggering event under paragraph (j)(1) of this section. As a result, under paragraph (c)(1)(i) of this section, UST must recognize and include in income $50x gain under the gain recognition agreement. Under paragraph (c)(1)(iii)(A) of this section, UST must report the $50x gain on an amended return filed for the taxable year of the initial transfer. Under paragraph (c)(1)(v) of this section, UST must pay applicable interest on any additional tax due with respect to the $50x gain recognized. Under section 1248(a), $30x of the gain recognized by UST under the gain recognition agreement is recharacterized as a dividend. Under paragraph (c)(4) of this section, as of the date of the initial transfer, the basis of the TFC stock received by UST in the initial transfer and the TFD stock received by TFC in the initial transfer, respectively, is increased by $50x. After taking into account the increase to the basis of the TFD stock, TFC recognizes $20x gain on the disposition of the TFD stock in year 3.

(B) *Gain recognition with an election.* If UST made an election under paragraph (c)(2)(vi) of this section with the gain recognition agreement filed for the initial transfer, the result would be the same as in paragraph (ii)(A) of this *Example 2*, except that UST must include in income the $50x gain recognized under the gain recognition agreement on its tax return filed for year 3. Any additional tax due with respect to the $50x gain and applicable interest on the additional tax due must be included with such return. The amount, if any, of the $50x gain recognized by UST under the gain recognition agreement that is characterized as a dividend under section 1248(a) is determined in year 3.

Example 3. Transfer of stock of the transferee foreign corporation to a domestic corporation in a section 351 exchange. (i) *Facts.* UST wholly owns DC. In year 3, pursuant to a section 351 exchange, UST transfers all of the TFC stock received in the initial transfer to DC in an exchange solely for voting stock of DC.

(ii) *Result.* The year 3 transfer of the TFC stock by UST to DC constitutes a triggering event under paragraph (j)(4) of this section. However, the transfer shall not constitute a triggering event pursuant to paragraph (k)(1)(ii) of this section if DC enters into a new gain recognition agreement with respect to the initial transfer that designates DC as the U.S. transferor for purposes of this section. Pursuant to paragraphs (c)(4)(i) and (ii) of this section, if DC is required to recognize gain under the new gain recognition agreement, the basis of the stock of TFC and TFD would be increased by the amount of gain recognized. However, pursuant to paragraph (c)(4)(iii) of this section, no adjustment

would be made to the basis of the DC voting stock received by UST in year 3 as a result of such gain recognition. Alternatively, if the conditions for the application of paragraph (k)(14) of this section are satisfied UST could instead enter into the new gain recognition agreement with respect to the initial transfer.

Example 4. Transfer of stock of the transferee foreign corporation in a triangular section 368(a)(1)(B) reorganization. (i) *Facts.* DC wholly owns FA. In year 3, pursuant to a triangular reorganization described in section 368(a)(1)(B), UST transfers all of the TFC stock received in the initial transfer to FA in exchange solely for 20% of the outstanding voting stock of DC. At the time of the reorganization, the TFC stock has a basis in excess of fair market value.

(ii) *Result.* (A) The transfer by UST of the TFC stock to FA is an indirect stock transfer under §1.367(a)–3(d)(1)(iii)(B). Accordingly, to preserve nonrecognition treatment, UST must enter into a separate gain recognition agreement under this section with respect to such transfer.

(B) With respect to the gain recognition agreement filed for the initial transfer of the TFD stock, the transfer by UST of the TFC stock to FA is a triggering event under paragraph (j)(4) of this section. However, the transfer shall not constitute a triggering event if the conditions of the exception provided by paragraph (k)(14) of this section are satisfied.

(*1*) The condition of paragraph (k)(14)(i) of this section is satisfied because the transfer qualifies as a nonrecognition transaction (assuming UST enters into a gain recognition agreement as described in paragraph (ii)(A) of this *Example 4*).

(*2*) The condition of paragraph (k)(14)(ii) of this section is satisfied because immediately after the transfer DC, a domestic corporation that is eligible to be a U.S. transferor, owns at least 5% (applying the attribution rules of section 318, as modified by section 958(b)) of the total voting power and total fair market value of the outstanding stock of FA. As a result, DC is treated as retaining an indirect interest in the TFD stock immediately following the transfer.

(*3*) The condition of paragraph (k)(14)(iii) of this section is satisfied if DC enters into a new gain recognition agreement with respect to the initial transfer of the TFD stock that, based on the principles of paragraph (j) of this section, describes the subsequent dispositions or other events that would constitute triggering events for purposes of the new gain recognition agreement (other than the dispositions and other events described in paragraph (j) of this section). For example, a complete or partial disposition of the stock of FA would constitute a triggering event for purposes of the new gain recognition agreement.

Example 5. Transfer of stock of the transferee foreign corporation to a domestic corporation pursuant to an asset reorganization. (i) *Facts.* At the time of the initial transfer the TFD stock has a $50x basis and a $100x fair market value. Therefore, the amount of gain subject to the gain recognition agreement is $50x. In year 3, pursuant to an asset reorganization described in section 368(a)(1)(A), UST transfers its assets to DC in exchange solely for 20% of the outstanding stock of DC. UST distributes the stock of DC to USP pursuant to the plan of reorganization.

(ii) *Result.* The transfer by UST of the TFC stock to DC constitutes a triggering event under paragraph (j)(4) of this section. However, pursuant to paragraph (k)(6)(i) of this section, if DC enters into a new gain recognition agreement with respect to the initial transfer that designates DC as the U.S. transferor, the transfer shall not constitute a triggering event.

Example 6. Transfer of stock of the transferee foreign corporation to a foreign corporation pursuant to an asset reorganization. (i) *Facts.* The facts are the same as in Example 5, except the acquiring corporation in the asset reorganization is FA, and, at the time of the asset reorganization, the TFC stock transferred by UST to FA has a $50x basis and a $150x fair market value. All of the conditions under section 367(a)(5) and the regulations under that section are satisfied, and no adjustment is required to the basis of the FA stock received by USP in the transaction.

(ii) *Result.* (A) The transfer by UST of the TFC stock to FA is described in section 361(a) and is therefore subject to section 367(a)(5). In general, UST cannot file a gain recognition agreement with respect to such transfer, and the transfer therefore is subject to the general rule of section 367(a)(1). However, if the conditions of §1.367(a)–3(e)(1)(i) through (iv) are satisfied, USP can enter into a gain recognition agreement with respect to the transfer to avoid the recognition of gain by UST on the transfer under section 367(a)(1). If the exception provided by paragraph (k)(14) of this section applies so that the transfer by UST of the TFC stock to FA is not a triggering event with respect to the gain recognition agreement filed for the initial transfer (discussed in paragraph (ii)(B) of this *Example 6*), the amount of gain subject to the gain recognition agreement (if entered into) with respect to the transfer by UST of the TFC stock to FA in the asset reorganization is $100x.

(B) Under paragraph (j)(4) of this section, the transfer of the TFC stock by UST to FA is a triggering event with respect to the gain recognition agreement for the initial transfer. The exception provided by paragraph (k)(6)(i) of this section does not apply to such transfer because FA, the acquiring corporation in the asset reorganization, is foreign. However, the transfer shall not constitute a

triggering event if the conditions of the exception provided by paragraph (k)(14) of this section are satisfied.

(*1*) The condition of paragraph (k)(14)(i) of this section is satisfied because the transfer of the TFC stock to FA qualifies as a nonrecognition transaction (assuming USP enters into a gain recognition agreement with respect to such transfer).

(*2*) The condition of paragraph (k)(14)(ii) of this section is satisfied because immediately after the transfer USP, a domestic corporation that is eligible to be a U.S. transferor, owns at least 5% (applying the attribution rules of section 318, as modified by section 958(b)) of the total voting power and total fair market value of the outstanding stock of FA. As a result, USP is treated as retaining an indirect interest in the TFD stock immediately following the transfer.

(*3*) The condition of paragraph (k)(14)(iii) of this section is satisfied if USP enters into a new gain recognition agreement with respect to the initial transfer of the TFD stock that, based on the principles of paragraph (j) of this section, describes the subsequent dispositions or other events that would constitute triggering events for purposes of the new gain recognition agreement, other than those already provided in paragraph (j) of this section. For example, a disposition of the stock of FA would constitute such a triggering event for purposes of the new gain recognition agreement.

(iii) *Alternate facts.* Assume the same facts as in paragraph (i) of this *Example 6*, including that paragraph (k)(14) of this section applies to the year 3 reorganization so that USP enters into a new gain recognition agreement with respect to the initial transfer of the TFD stock that occurred in year 1 (GRA 1), and that under §1.367(a)–3(e) USP enters into a separate gain recognition agreement with respect to the initial transfer of the TFC stock by UST to FA pursuant to the year 3 asset reorganization (GRA 2). Assume further that in year 4 TFC disposes of 10% of the TFD stock pursuant to a transaction that constitutes a triggering event with respect to GRA 1. The disposition of the TFD stock is not a triggering event with respect to GRA 2 because the TFD stock disposed of does not constitute substantially all the assets of TFC. Under paragraphs (j)(1) and (c)(1)(i) of this section, USP must recognize $5x gain (10% of $50x) under GRA 1. Under paragraph (c)(4)(i) and (ii) of this section, as of the date of the initial transfer (with respect to which GRA 1 was filed), the basis of the TFC stock and TFD stock, respectively, is increased by $5x. Under paragraph (c)(1)(i) of this section, the amount of gain subject to GRA 1 is reduced from $50x to $45x. Similarly, because the transferred stock for purposes of GRA 2 is the TFC stock, the amount of gain subject to GRA 2 is reduced from $100x to $95x to reflect the increase to the basis of the TFC stock.

Example 7. Transfer of transferred stock to a foreign corporation pursuant to an asset reorganization. (i) *Facts.* UST wholly owns FA. In year 4, pursuant to a reorganization described in section 368(a)(1)(D), TFC transfers all of the TFD stock to FA in exchange solely for stock of FA. TFC distributes the FA stock to UST pursuant to the plan of reorganization.

(ii) *Analysis.* In general, the year 4 transfer by TFC of the TFD stock to FA and the exchange by UST of the TFC stock for FA stock constitute triggering events under paragraphs (j)(1) and (4) of this section, respectively. However, under paragraph (k)(6)(ii) of this section, the transfers shall not constitute triggering events if UST enters into a new gain recognition agreement with respect to the initial transfer that designates FA as the transferee foreign corporation.

Example 8. Transfer of substantially all the assets of the transferred corporation pursuant to an asset reorganization. (i) *Facts.* In year 4, pursuant to an asset reorganization described in section 368(a)(1)(C), TFD transfers all of its assets to FA in exchange solely for voting stock of FA. TFD distributes the FA voting stock to TFC pursuant to the plan of reorganization.

(ii) *Analysis.* The year 4 transfer by TFD of all its assets to FA and the exchange by TFC of its TFD stock for FA voting stock pursuant to the reorganization constitute triggering events under paragraphs (j)(2) and (j)(1) of this section, respectively. However, under paragraph (k)(6)(iii) of this section, the transfers shall not constitute triggering events if UST enters into a new gain recognition agreement with respect to the initial transfer that designates FA as the transferred corporation. In addition, under paragraph (k)(6)(iii) of this section only the assets of TFD acquired by FA in the asset reorganization shall be treated as assets of the transferred corporation for purposes of the new gain recognition agreement.

Example 9. Complete liquidation of transferred corporation into transferee foreign corporation. (i) *Facts.* UST does not make an election under paragraph (c)(2)(vi) of this section in connection with the gain recognition agreement entered into with respect to the initial transfer. In year 3, TFD distributes all of its assets to TFC pursuant to a complete liquidation to which sections 332 and 337 apply. Under paragraph (k)(8) of this section, UST enters into a new gain recognition agreement with respect to the initial transfer such that the liquidation is not a triggering event. Under paragraph (c)(5)(i) of this section, the new gain recognition agreement is subject to the conditions and requirements of this section to the same extent as the existing gain recognition agreement, except

that the transferred stock is no longer subject to the gain recognition agreement because the transferred stock is cancelled by reason of the liquidation. In year 5 TFC disposes of substantially all of the assets received from TFD in the year 3 liquidation.

(ii) *Result.* The year 5 disposition by TFC of substantially all of the assets received from TFD in the year 3 liquidation is a triggering event under paragraph (j)(2) of this section, and therefore UST must recognize the gain subject to the gain recognition agreement. UST must report the gain recognized on an amended return for the taxable year during which the initial transfer occurred. UST must also pay applicable interest on any additional tax due with respect to the gain recognized. Under paragraph (c)(4)(i) of this section, the basis of the TFC stock received by UST in the initial transfer is increased as of the date of the initial transfer by the amount of gain recognized under the gain recognition agreement. The basis of the assets of TFD, however, is not increased.

Example 10. Transfer of transferred stock to foreign corporation in section 351 exchange, followed by a section 332 liquidation of the foreign corporation. (i) *Facts.* In year 3, pursuant to a section 351 exchange, TFC transfers the TFD stock to F1, a newly formed corporation, in exchange solely for voting stock of F1. The transfer by TFC of the TFD stock to F1 is not a triggering event because UST complies with the conditions of paragraph (k)(3) of this section. In year 5, F1 distributes all of its assets to TFC in a complete liquidation to which sections 332 and 337 apply.

(ii) *Result.* The distribution of the TFD stock by F1, and the exchange of F1 stock by TFC pursuant to the year 5 liquidation of F1 constitute triggering events under paragraphs (j)(1) and (k)(3)(i) of this section, respectively. However, if paragraph (k)(14) of this section applies, neither the distribution of the TFD stock by F1, nor the exchange by TFC of the F1 stock, shall constitute a triggering event.

(A) The condition of paragraph (k)(14)(i) of this section is satisfied because the distribution of the TFD stock, and the exchange of F1 stock, both qualify as nonrecognition transactions.

(B) The condition of paragraph (k)(14)(ii) of this section is satisfied because immediately after the distribution UST, a domestic corporation that is eligible to be a U.S. transferor, owns at least 5% (applying the attribution rules of section 318, as modified by section 958(b)) of the stock of TFC. As a result, UST is treated as retaining an indirect interest in the TFD stock following the complete liquidation of F1.

(C) The condition of paragraph (k)(14)(iii) of this section is satisfied if UST enters into a new gain recognition agreement. Because after the complete liquidation of F1, UST wholly owns TFC, which wholly owns TFD, as was the case immediately after the initial transfer, UST is not required to describe, with the new gain recognition agreement, other dispositions or events that would constitute triggering events based on the principles of paragraph (j) of this section, other than the dispositions or events described in paragraph (j) of this section.

Example 11. Disposition of stock of transferee foreign corporation pursuant to a divisive reorganization. (i) *Facts.* In year 3, pursuant to a divisive reorganization described in section 368(a)(1)(D), UST transfers all of the TFC stock to DC, a newly-formed corporation, in exchange solely for stock of DC. UST then distributes all of the DC stock to USP in a transaction to which section 355 applies.

(ii) *Result.* The transfer of the TFC stock by UST to DC constitutes a triggering event under paragraph (j)(4) of this section. However, under paragraph (k)(1)(iii) of this section, the transfer of the TFC stock shall not constitute a triggering event if DC enters into a new gain recognition agreement that designates DC as the U.S. transferor for purposes of this section.

(iii) *Alternate facts.* The facts are the same as in paragraph (i) of this *Example 11,* except that UST transfers only 90% of the TFC stock to DC. Paragraph (k)(1)(iii) of this section applies only with respect to the TFC stock transferred to DC. Thus, the conditions of paragraph (k)(1)(iii) of this section are satisfied if DC enters into a new gain recognition agreement with respect to the TFC stock received from UST. The amount of gain subject to the new gain recognition agreement entered into by DC equals 90% of the amount of gain subject to the gain recognition agreement entered into by UST with respect to the initial transfer. The amount of gain subject to the gain recognition agreement entered into by UST with respect to the initial transfer is reduced by the amount of gain subject to the new gain recognition agreement entered into by DC. The gain recognition agreement entered into by UST with respect to the initial transfer continues to apply to the remaining TFC stock held by UST.

Example 12. Disposition of transferred stock pursuant to a divisive reorganization. (i) *Facts.* In year 3, pursuant to a divisive reorganization described in section 368(a)(1)(D), TFC transfers all of the TFD stock to F1, a newly formed corporation, in exchange solely for all of the outstanding stock of F1. TFC then distributes all of the F1 stock to UST in a transaction to which section 355 applies.

(ii) *Result.* The transfer by TFC of the TFD stock to F1 constitutes a triggering event under paragraph (j)(1) of this section. However, if paragraph (k)(14) of this section applies, neither the transfer of the TFD stock by TFC to F1, nor the distribution of the F1 stock by TFC to UST, shall constitute triggering events.

(A) The condition of paragraph (k)(14)(i) of this section is satisfied because the dispositions of the TFD stock and F1 stock qualify as nonrecognition transactions.

(B) The condition of paragraph (k)(14)(ii) of this section is satisfied because immediately after the transfer UST, an eligible U.S. transferor, owns at least 5% (applying the attribution rules of section 318, as modified by section 958(b)) of the total voting power and the total fair market value of the outstanding stock of F1. As a result, UST is treated as retaining an indirect interest in the TFD stock following the dispositions.

(C) The condition of paragraph (k)(14)(iii) of this section is satisfied if UST enters into a new gain recognition agreement with respect to the initial transfer that describes the subsequent dispositions or other events that would constitute triggering events based on the principles of paragraph (j) of this section, other than those described in paragraph (j) of this section. For example, a complete or partial disposition of the F1 stock would constitute a triggering event for purposes of the new gain recognition agreement (subject to the exceptions provided by paragraph (k) of this section).

Example 13. Receipt of boot by the transferee foreign corporation in a subsequent section 351 exchange. (i) *Facts.* At the time of the initial transfer, the TFD stock has a $50x basis and $100x fair market value. The amount of gain subject to the gain recognition agreement is $50x. In year 3, TFC and X, an unrelated foreign corporation, form F1. TFC transfers the TFD stock to F1 in exchange for $35x cash and $65x stock of F1. At the time of the transfer, the TFD stock has a $50x basis and $100x fair market value. The F1 stock received by TFC represents 25% of the outstanding stock of F1. Without regard to the gain recognized under the gain recognition agreement and any adjustments to basis under paragraph (c)(4)(ii) of this section, under section 351(b) TFC would recognize $35x gain in connection with the transfer of the TFD stock to F1. UST complies with the conditions of paragraph (k)(3) of this section, and therefore the disposition by TFC of the TFD stock does not constitute a triggering event.

(ii) *Result.* Under paragraph (m)(1) of this section, UST must recognize $35x gain under the gain recognition agreement as a result of the year 3 disposition by TFC of the TFD stock. Thus, the amount of gain subject to the new gain recognition agreement entered into by UST pursuant to paragraph (k)(3) of this section is $15x. Under paragraph (c)(4)(ii) of this section, as of the date of the initial transfer, the basis of the TFD stock held by TFC is increased by $35x, the amount of the gain recognized by UST under the gain recognition agreement. Under paragraph (c)(4)(i) of this section, the basis of the TFC stock received by UST in the initial transfer is also increased by $35x. After taking into account the increase to the basis of the TFD stock under paragraph (c)(4)(ii) of this section, TFC recognizes $15x gain under section 351(b) in connection with the year 3 transfer of the TFD stock to F1. Under section 362(a), the basis of the TFD stock in the hands of F1 is $100x.

Example 14. Complete disposition of transferred stock pursuant to a section 304(a)(1) transaction. (i) *Facts.* UST wholly owns FA. In year 3, in a transaction to which section 304(a)(1) applies, TFC transfers all of the TFD stock to FA in exchange for cash. Under section 304(a)(1), TFC and FA are treated as if TFC transferred the TFD stock to FA in a section 351 exchange in exchange solely for FA stock, and then FA redeemed the FA stock deemed issued in exchange for the cash. Under section 302(d), the redemption of the FA stock deemed issued by FA to TFC under section 304(a)(1) is treated as a distribution to which section 301 applies.

(ii) *Result.* (A) In general, the deemed contribution by TFC of the TFD stock to FA in the section 351 exchange is a triggering event under paragraph (j)(1) of this section. However, under paragraph (k)(3) of this section the deemed contribution shall not be a triggering event if UST enters into a new gain recognition agreement with respect to the initial transfer in which it agrees to treat as a triggering event a complete or partial disposition of the FA stock deemed received by TFC.

(B) Under paragraph (n)(1) of this section, the redemption of the FA stock deemed received by TFC in exchange for the TFD stock shall not constitute a disposition if UST enters into a new gain recognition agreement with respect to the initial transfer that includes appropriate provisions to take into account such redemption. Therefore, under the new gain recognition agreement UST must agree to treat as a triggering event a complete or partial disposition of the stock of FA. Pursuant to paragraph (d)(2)(ii) of this section, UST is permitted to enter into a single new gain recognition agreement in year 3, but the gain recognition agreement must provide a complete description of the section 304(a)(1) transaction including the deemed section 351 exchange and redemption of the FA stock.

Example 15. Reduction in amount of gain subject to gain recognition agreement, followed by triggering event. (i) *Facts.* In year 3, UST disposes of 60% of the TFC stock received in the initial transfer in a transaction in which the conditions of paragraph (o)(1)(ii) of this section are satisfied. Thus, the amount of gain subject to the gain recognition agreement is reduced by 60%. In year 5, TFC disposes of 50% of the TFD stock in a transaction that constitutes a triggering event.

(ii) *Result.* As a result of the year 5 disposition by TFC of 50% of the TFD stock, under

paragraphs (j)(1) and (c)(1)(i) of this section, UST must recognize and include in income 50% of the gain subject to the gain recognition agreement (because of the year 3 disposition of TFC stock, the amount of gain subject to the gain recognition agreement equals 40% of the gain realized, but not recognized, on the initial transfer). UST must pay applicable interest on any additional tax due with respect to the gain recognized. The amount of gain subject to the gain recognition agreement is reduced by the amount of gain recognized by UST (the remaining gain equals 20% of the gain realized, but not recognized, by UST on the initial transfer).

Example 16. Taxable sale of stock of transferee foreign corporation and election to reduce stock basis. (i) *Facts.* UST wholly owns F1 and TFD. The F1 stock has a $100x basis and $90x fair market value, and the TFD stock has a $0x basis and $100x fair market value. UST also owns real property with a $10x basis and $10x fair market value. In year 1, pursuant to a section 351 exchange, UST transfers the real property, the TFD stock, and the F1 stock to TFC in exchange solely for 20 shares of TFC stock. UST enters into a gain recognition agreement with respect to the transfer of the TFD stock. The amount of the gain recognition agreement is $100x. UST takes the position that the basis of each share of TFC stock received in the exchange is $5.5x (a proportionate amount of the $110x aggregate basis of the transferred property). In year 3, UST disposes of all its TFC stock in a transaction in which all gain realized is recognized and included in taxable income.

(ii) *Result.* The year 3 disposition of the TFC stock is a triggering event under paragraph (j)(4) of this section. The disposition does not terminate the gain recognition agreement pursuant to paragraph (o)(1)(i) of this section because the basis of each share of TFC stock received in exchange for the TFD stock in the initial transfer is $5.5x, which exceeds the $0x basis of the TFD stock at time of the initial transfer. However, under paragraph (o)(1)(iii) of this section, to satisfy the basis condition of paragraph (o)(1)(i) of this section, UST can reduce the basis of the 10 shares of the TFC stock received in exchange for the TFD stock to $0x. If UST reduces the basis of the 10 shares of TFC stock to $0x, under paragraph (o)(1)(i) of this section the disposition of the TFC stock shall not constitute a triggering event but instead shall terminate the gain recognition agreement without further effect.

Example 17. Successive section 351 exchanges, section 301 distributions, and transactions involving partnerships. (i) *Facts.* UST owns a 40 percent capital and profits interest in a foreign partnership (PRS). PRS wholly owns TFD and other assets with basis equal to fair market value. The TFD stock has a $50x basis and $200x fair market value. TFC wholly owns F1. On day 1 of year 1, in a section 351 exchange, UST transfers its PRS interest to TFC in exchange solely for stock of TFC (initial transfer). On that same day, in a section 351 exchange, TFC transfers the PRS interest received from UST to F1 in exchange solely for stock of F1. In year 3, PRS receives a $150x distribution from TFD to which section 301 applies. Under section 301(c), $25x of the distribution constitutes a dividend, $50x is applied against and reduces the basis of the TFD stock held by PRS, and the remaining $75x is treated as gain from the sale or exchange of property. With respect to the TFD stock deemed transferred by UST in the initial transfer, under section 301(c), $10x (40% of $25x) of the distribution constitutes a dividend, $20x (40% of $50x) is applied against and reduces the basis of TFD stock, and $30x (40% of $75x) is treated as gain from the sale or exchange of property. In year 5, pursuant to a distribution to which section 731 applies, PRS distributes all of the TFD stock to F1.

(ii) *Result.* (A) *Successive section 351 transfers.* Under section 367(a)(4) and §1.367(a)-1T(c)(3)(ii), the transfer of the PRS interest by UST to TFC is treated, for purposes of section 367(a), as a transfer by UST to TFC of its proportionate share of the TFD stock held by PRS (the initial transfer). The initial transfer by UST of the TFD stock to TFC is subject to the general rule of section 367(a)(1), unless UST enters into a gain recognition agreement with respect to such transfer pursuant to §1.367(a)–3(b)(1)(ii) and this section. Under paragraph (c)(3)(viii) of this section, the gain recognition agreement must include a complete description of the transfer, including a description of the partners of PRS. Even if UST enters into a gain recognition agreement with respect to the initial transfer, under paragraph (j)(3) of this section, the subsequent transfer by TFC of the PRS interest to F1 is a triggering event unless UST enters into a new gain recognition agreement with respect to the initial transfer under paragraph (k)(14) that provides that, in addition to the triggering events provided in paragraph (j) of this section, a complete or partial disposition of the F1 stock received by TFC in exchange for the PRS interest shall constitute a triggering event for purposes of the gain recognition agreement. The new gain recognition agreement must also provide that any other disposition that is inconsistent with the principles of paragraph (k), including an indirect disposition of the TFD stock or of substantially all of the assets of TFD, shall constitute a triggering event for purposes of the new gain recognition agreement. Under paragraph (d)(2)(ii) of this section, UST is permitted to enter into a single gain recognition agreement with respect to the initial transfer and the subsequent transfer by TFC of the PRS interest, but the agreement must include a complete description of the initial

transfer and the subsequent transfer of the PRS interest.

(B) *Section 301 distribution from TFD to PRS.* Under paragraph (b)(1)(iii) of this section, the section 301 distribution received by PRS from TFD is not a disposition (and therefore does not affect the gain recognition agreement) to the extent it is described in section 301(c)(1) or (2). However, under paragraph (n)(2) of this section, to the extent the distribution is described in section 301(c)(3), UST must recognize gain ($30x) under the gain recognition agreement. For this purpose, the amount of the distribution that is described in section 301(c)(3) is determined before taking into account the increase to the basis of the TFD stock under paragraph (c)(4)(ii) of this section.

(C) *Distribution of TFD stock by PRS to F1.* The year 5 distribution of the TFD stock by PRS to F1 is a triggering event under paragraph (j)(1) of this section, unless paragraph (k)(14) of this section applies.

(*1*) The condition of paragraph (k)(14)(i) of this section is satisfied because the distribution qualifies as a nonrecognition transaction.

(*2*) The condition of paragraph (k)(14)(ii) of this section is satisfied because immediately after the distribution UST, a domestic corporation that is eligible to be a U.S. transferor, owns at least 5% (applying the attribution rules of section 318, as modified by section 958(b)) of the total voting power and total value of the outstanding stock of F1. As a result, UST is treated as retaining an indirect interest in the TFD stock following the distribution.

(*3*) The condition of paragraph (k)(14)(iii) of this section is satisfied if UST enters into a new gain recognition agreement with respect to the initial transfer. The new gain recognition agreement need not describe additional dispositions or other events that would constitute triggering events because, pursuant to paragraph (c)(5) of this section, the dispositions or other events described in paragraph (j) of this section or in the existing gain recognition agreement apply to the new gain recognition agreement.

Example 18. Complete liquidation of transferee foreign corporation. (i) *Facts.* TFD has 10 shares of stock outstanding immediately before the initial transfer. On the date of the initial transfer, the TFD stock has a $0x basis and $90x fair market value. In year 2, in exchange for 1 share of TFD stock TFC transfers real estate to TFD with a $10x basis and $10x fair market value. In year 4, TFC distributes the 11 shares of TFD stock to UST in a complete liquidation to which sections 332 and 337 apply.

(ii) *Result.* In determining whether the gain recognition agreement entered into by UST with respect to the initial transfer is terminated under paragraph (o)(5) of this section, or triggered under paragraphs (j)(1) and (j)(4) of this section, only the 10 shares of TFD stock transferred by UST in the initial transfer are considered. Thus, the 1 share of TFD stock received by TFC in exchange for the real estate in year 2 is not taken into account.

Example 19. Spin-off of transferred corporation. (i) *Facts.* Before the initial transfer, the TFD stock has an $80x basis and a $100x fair market value, and the TFC stock has a $100x basis and a $100x fair market value. In year 4, TFC distributes all of the TFD stock to UST in a transaction to which section 355 applies. At the time of the distribution, the TFD stock has a $200x fair market value, and the TFC stock (without regard to the value of the TFD stock held by TFC) has a $100x fair market value. At such time, the TFC stock has a $180x basis. As determined under section 358, immediately after the distribution, the TFC stock has a $60x basis, and the TFD stock has a $120x basis.

(ii) *Result.* The distribution of the TFD stock by TFC in year 4 is a triggering event under paragraph (j)(1) of this section. The distribution does not terminate the gain recognition agreement under paragraph (o)(5) of this section because after the distribution, the basis of the TFD stock in the hands of UST ($120x) is greater than the basis of the TFD stock at the time of the initial transfer ($80x). However, if UST reduces the basis of the TFD stock to $80x (as provided under paragraph (o)(5)(iii) of this section) the gain recognition agreement will terminate without further effect. If UST does not elect to reduce the basis of the TFD stock, see paragraph (k)(14) of this section.

Example 20. Intercompany transaction followed by disposition to nonmember. (i) *Facts.* At the time of the initial transfer, the TFD stock has a $50x basis and $100x fair market value. The amount of the gain recognition agreement is $50x. In year 3, UST distributes all of the TFC stock to USP in a transaction to which section 301 applies. At the time of the distribution, the TFC stock has a $50x basis and $90x fair market value. Under section 311(b), UST must recognize $40x gain (the intercompany item) on the distribution, but because the distribution is an intercompany transaction, under the provisions of §1.1502–13, the $40x gain is not taken into account in year 3. In year 4, USP sells all of the TFC stock to X, an unrelated corporation. Under the provisions of §1.1502–13, in year 4 UST takes into account the $40x intercompany item as a result of the sale of the TFC stock to X.

(ii) *Result.* (A) The year 3 distribution of the TFC stock by UST to USP does not terminate the gain recognition agreement under paragraph (o)(1) of this section because UST does not include the $40x gain in taxable income during year 3. Under paragraph (j)(4) of this section, the year 3 distribution of the TFC stock by UST to USP is generally

a triggering event; however, because the distribution is an intercompany transaction that creates an intercompany item, the distribution shall not constitute a triggering event if the conditions of paragraph (k)(12)(i) of this section are satisfied.

(1) The condition of paragraph (k)(12)(i)(A) of this section is satisfied because the aggregate basis of the TFC stock distributed ($50x) is not greater than the sum of the aggregate basis of the TFD stock at the time of the initial transfer ($50x).

(2) The condition of paragraph (k)(12)(i)(B) of this section is satisfied if the next annual certification for the existing gain recognition agreement includes a complete description of the intercompany transaction and an explanation of how the basis condition of paragraph (k)(12)(i)(A) of this section is satisfied.

(B) Under paragraph (o)(6) of this section and the principles of paragraph (o)(1)(i) of this section, because the year 4 sale of the TFC stock to X requires UST to take into account the $40x gain (the intercompany item) from the year 3 distribution, the year 4 sale terminates the gain recognition agreement. If, alternatively, in year 4 USP had sold only 30% of the TFC stock, then under paragraph (o)(6) of this section and the principles of paragraph (o)(1)(ii) of this section the amount of gain subject to the gain recognition agreement would be reduced by 30%.

(iii) *Alternate facts. Intercompany transaction followed by sale of transferee foreign corporation to member.* Assume the same facts as in paragraph (i) of this Example 20, except that, instead of USP selling the TFC stock to X, in year 4 USP sells the TFC stock to USS in exchange for $90x cash. UST and USS are members of the USP consolidated group immediately after the sale. The results of the year 3 distribution of the TFC stock by UST to USP are the same as in paragraph (ii) of this *Example 20.* In addition, under paragraph (k)(12)(ii) of this section, the year 4 sale by USP of the TFC stock to USS is not a triggering event, provided UST includes a complete description of the sale with the annual certification filed for the gain recognition agreement in year 4.

(iv) *Alternate facts. Intercompany transaction followed by complete liquidation of transferee foreign corporation.* Assume the same facts as in paragraph (i) of this *Example 20,* except that, instead of USP selling the TFC stock to X, in year 4 TFC distributes all of its assets to USP in a complete liquidation to which sections 332 and 337 apply. The result is the same as in paragraph (ii) of this *Example 20* because, under the provisions of §1.1502–13, in year 4 UST takes into account the $40x gain (the intercompany item) from the year 3 distribution.

(v) *Alternate facts. Intercompany transaction followed by triggering event.* Assume the same facts as in paragraph (i) of this *Example 20,* except that instead of USP selling the TFC stock to X, in year 4 TFC disposes of all of the TFD stock in a transaction that constitutes a triggering event under paragraph (j)(1) of this section. Under paragraph (c)(1)(i) of this section UST must recognize $50x gain under the gain recognition agreement. Under paragraphs (c)(4)(i) and (ii) of this section, as of the date of the initial transfer the basis of the TFC stock and TFD stock, respectively, is increased by $50x.

(vi) *Alternate facts. Intercompany transaction followed by section 351 transfer to member.* The facts are the same as in paragraph (i) of this *Example 20,* except that, in year 3, in a section 351 exchange UST transfers all of the TFC stock to USS in exchange for $10x cash and $80x of stock of USS. USS is a member of the USP consolidated group immediately after the exchange. The transfer of the TFC stock by UST to USS is an intercompany transaction. Under section 351(b), UST must generally recognize $10x gain (intercompany item) in connection with the transfer; however, under the provisions of §1.1502–13, UST does not take the $10x gain into account in year 3. Under paragraph (k)(12) of this section, as result of the intercompany transaction creating an intercompany item ($10x gain), the existing gain recognition agreement ($50x gain) must be divided between UST and USS. UST shall remain subject to a gain recognition agreement of $10x (equal to the amount of the intercompany item). The amount of the gain recognition agreement entered into by USS under paragraph (k)(1) of this section is $40x (equal to the amount of the existing gain recognition agreement, reduced by the amount of the of the gain recognition agreement to which UST remains subject).

Example 21. Transfer of transferred stock to United States person other than U.S. transferor. (i) *Facts.* An individual (A) that is a United States citizen wholly owns TFD, TFC, and DC. A transfers the TFD stock to TFC in a section 351 exchange and enters into a gain recognition agreement with respect to such transfer. In year 5, pursuant to an asset reorganization, TFC transfers all of its assets to DC in exchange solely for DC stock. TFC distributes the DC stock to A pursuant to the plan of reorganization.

(ii) *Result.* The transfer by TFC of the TFD stock to DC and the exchange by A of the TFC stock for DC stock pursuant to the asset reorganization are triggering events under paragraphs (j)(1) and (j)(4) of this section, respectively. The gain recognition agreement does not terminate under paragraph (o)(5) of this section because DC is neither the U.S. transferor, nor an individual that is a United States person, nor a member of the same consolidated group of which the U.S. transferor is a member. However, if paragraph (k)(14) of this section applies the

exchanges shall not constitute triggering events.

(A) The condition of paragraph (k)(14)(i) of this section is satisfied because the transfer of the TFD stock to DC qualifies as a nonrecognition transaction.

(B) The condition of paragraph (k)(14)(ii) of this section is satisfied because immediately after the transfer DC, a domestic corporation that is eligible to be a U.S. transferor, retains a direct interest in the TFD stock following the transfer.

(C) The condition of paragraph (k)(14)(iii) of this section is satisfied if DC enters into a new gain recognition agreement with respect to the initial transfer. Under paragraph (k)(14)(iii)(B) of this section, DC is not required to describe any subsequent dispositions or other events that (based on the principles of paragraph (j) of this section) would constitute triggering events for purposes of the new gain recognition agreement, other than the dispositions or other events described in paragraph (j) of this section, because DC holds a direct interest in TFD after the asset reorganization.

Example 22. Transfer of transferred stock to consolidated group member. (i) *Facts.* UST wholly owns DC, a member of the USP consolidated group that includes UST. In year 5, pursuant to an asset reorganization described in section 368(a)(1)(A) TFC merges with and into DC. Immediately after the asset reorganization, DC wholly owns TFD, and the basis of the TFD stock is not greater than the aggregate basis of such stock at the time of the initial transfer.

(ii) *Result.* The gain recognition agreement filed by UST with respect to the initial transfer terminates without further effect if the conditions of paragraph (o)(5) of this section are satisfied.

(A) The condition of paragraph (o)(5)(i) of this section is satisfied because the transfer of the TFD stock is a section 361 exchange.

(B) The condition of paragraph (o)(5)(ii) of this section is satisfied because DC is a member of the consolidated group that includes UST immediately after the section 361 exchange.

(C) The condition of paragraph (o)(5)(iii) of this section is satisfied because the aggregate basis of the TFD stock immediately after the section 361 exchange is not greater than the aggregate basis of the TFD stock at the time of the initial transfer (as adjusted for any gain recognized by UST on such transfer). If the basis condition of paragraph (o)(5)(iii) were not satisfied, under paragraph (o)(5)(iii) of this section, DC could reduce the basis of the TFD stock received in the reorganization. Alternatively, a new gain recognition agreement could be entered into if paragraph (k)(14) of this section applied to the disposition of the TFD stock pursuant to the section 361 exchange.

(iii) *Alternate facts.* The facts are the same as in paragraph (i) of this *Example 22,* except that instead of TFC merging into DC, TFC merges into TFD in a reorganization described in section 368(a)(1)(A). The gain recognition agreement terminates without further effect if the conditions of paragraph (o)(5) of this section are satisfied.

(A) The condition of paragraph (o)(5)(i) of this section is satisfied because the TFD stock issued by TFD to TFC in the reorganization, which is treated as transferred stock under paragraph (b)(2)(iii) of this section, is distributed by TFC to UST pursuant to section 361(c).

(B) The condition of paragraph (o)(5)(ii) of this section is satisfied because UST is the U.S. transferor.

(C) The condition of paragraph (o)(5)(iii) of this section is satisfied if the aggregate basis of the TFD stock received by UST from TFC is not greater than the aggregate basis of the TFD stock at the time of the initial transfer (as adjusted for any gain recognized by UST on such transfer). If the basis condition of paragraph (o)(5)(iii) were not satisfied, under paragraph (o)(5)(iii) of this section, UST could reduce the basis of the TFD stock received in the reorganization.

Example 23. Split-off of transferred stock. (i) *Facts.* X, a domestic corporation that is unrelated to USP and UST, wholly owns TFC. Pursuant to a reorganization described in section 368(a)(1)(B), UST transfers all of the TFD stock to TFC in exchange for 50% of the outstanding voting stock of TFC. UST enters into a gain recognition agreement with respect to such transfer. In year 4, in a split-off transaction to which section 355 applies, TFC distributes all of the TFD stock to X in exchange for all the TFC stock held by X.

(ii) *Result.* Under paragraph (j)(1) of this section, the year 4 distribution of the TFD stock to X constitutes a triggering event. However, the distribution shall not constitute a triggering event if paragraph (k)(14) of this section applies. The gain recognition agreement does not terminate under paragraph (o)(5) of this section because X is not a recipient described in paragraph (o)(5)(ii) of this section.

(A) The condition of paragraph (k)(14)(i) of this section is satisfied because the distribution of the TFD stock qualifies as a nonrecognition transaction.

(B) The condition of paragraph (k)(14)(ii) of this section is satisfied because immediately after the distribution X, a domestic corporation that is eligible to be a U.S. transferor, retains a direct interest in the TFD stock.

(C) The condition of paragraph (k)(14)(iii) of this section is satisfied if X enters into a new gain recognition agreement with respect to the initial transfer. Under paragraph

(k)(14)(iii)(B) of this section, X is not required to describe, with the new gain recognition agreement, any subsequent dispositions or other events that (based on the principles of paragraph (j) of this section) would constitute triggering events, other than the dispositions described in paragraph (j) of this section, because X directly owns TFD after the distribution.

(D) If X were a United States citizen, the gain recognition agreement would terminate if the condition of paragraph (o)(5)(iii) of this section were satisfied. Alternatively, the gain recognition agreement would continue for its remaining term if the conditions for the application of paragraph (k)(14) of this section were satisfied.

(iii) *Alternate facts. Distribution to unrelated foreign corporation.* The facts are the same as in paragraph (i) of this *Example 23,* except that X is a foreign corporation wholly owned by DC. DC is unrelated to UST. The results are the same as in paragraph (ii) of this *Example 23,* except as follows.

(A) The condition of paragraph (k)(14)(ii) of this section is satisfied because immediately after the distribution DC, a domestic corporation that is eligible to be a U.S. transferor, owns at least 5% (applying the attribution rules of section 318, as modified by section 958(b)) of the total voting power and total value of the outstanding stock of X. As a result, DC is treated as retaining an indirect interest in the TFD stock immediately following the distribution.

(B) The condition of paragraph (k)(14)(iii) of this section is satisfied if DC enters into a new gain recognition agreement with respect to the initial transfer. Under paragraph (k)(14)(iii)(B) of this section, DC must, in addition to the dispositions described in paragraph (j) of this section, include as a triggering event a complete or partial disposition of the stock of X.

(iv) *Alternate facts. Distribution to nonresident alien individual.* The facts are the same as in paragraph (i) of this *Example 23,* except that X is a nonresident alien individual. Paragraph (k)(14) of this section does not apply to the distribution because the conditions of paragraph (k)(14)(ii) and (iii) of this section cannot be satisfied. Therefore, the distribution is a triggering event, and UST will recognize gain under the gain recognition agreement as required under paragraphs (c)(1)(i) and (v) of this section. The result would be the same if X were a foreign corporation and, immediately after the distribution, no United States person owned at least 5% (applying the attribution rules of section 318, as modified by section 958(b)) of the total voting power and value of the outstanding stock of X.

Example 24. Applicability of this section to gain recognition agreements filed before March 13, 2009. (i) *Facts.* The facts are the same as in paragraph (i) of *Example 6,* except that the initial transfer occurred on March 7, 2007, and the asset reorganization occurred on July 1, 2008.

(ii) *Result.* Under paragraph (r)(1)(ii) of this section, the rules of §1.367(a)-8T (see 26 CFR part 1, revised April 1, 2007) apply to the transfers pursuant to the asset reorganization because the initial transfer occurred on March 7, 2007. As a result of the disposition of the TFC stock pursuant to the asset reorganization, under §1.367(a)-8T(d), USP is required to recognize the gain subject to the gain recognition agreement and pay applicable interest on any additional tax due with respect to such gain. Because the acquiring corporation in the asset reorganization is foreign, an exception under §1.367(a)-8T(e) is not available for the exchange of TFC stock by USP. However, pursuant to paragraph (r)(2)(i) of this section, because the exception provided by paragraph (k)(14) of this section is not included in §1.367(a)-8T, USP may apply paragraph (k)(14) of this section to such exchange (provided the conditions of paragraph (k)(14) of this section are satisfied), if the statute of limitations on assessments of tax for the 2007 tax year has not closed. If USP applies paragraph (k)(14) of this section to its exchange of the TFC stock pursuant to the asset reorganization, under paragraph (r)(2)(ii) of this section USP must include the new gain recognition agreement required under paragraph (k)(14)(iii) of this section with an amended Federal income tax return for its 2008 tax year that is filed August 10, 2009.

Example 25. Applicability of this section to gain recognition agreements filed before March 13, 2009. (i) *Facts.* The initial transfer occurs in 2004. In 2005, pursuant to a section 351 exchange, TFC transfers the TFD stock to F1 in exchange solely for F1 voting stock. UST does not file a new gain recognition agreement under §1.367(a)-8(g)(2) with respect to the exchange.

(ii) *Result.* Under paragraph (r)(1)(ii) of this section, the rules of §1.367(a)-8 (see 26 CFR part 1, revised April 1, 2006) apply to the year 2005 disposition of the TFD stock because UST filed the gain recognition agreement after July 20, 1998, but before March 7, 2007. Under §1.367(a)-8(e) (see 26 CFR part 1, revised April 1, 2006), as a result of the disposition of the TFD stock by TFC, UST must recognize the amount of gain subject to the gain recognition agreement. Paragraph (r)(2)(i) of this section does not apply because the rule provided by paragraph (k)(3) of this section was included in §1.367(a)-8(g)(2) (see 26 CFR part 1, revised April 1, 2006). However, UST may request relief for reasonable cause under §1.367(a)-8(c)(2) (see 26 CFR part 1, revised April 1, 2006) to file a new gain recognition agreement with respect to the disposition of the TFD stock by TFC in 2005.

(r) *Effective/applicability date*—(1) *General rule*—(i) *Transfers occurring on or after March 13, 2009; relief for certain failures that are not willful.* The rules of this section apply to gain recognition agreements filed with respect to transfers of stock or securities occurring on or after March 13, 2009. However, the rules of this section do not apply to gain recognition agreements filed with respect to any such transfer occurring on or after March 13, 2009, if such transfer was entered into pursuant to a written agreement that was (subject to customary conditions) binding before February 11, 2009, and at all times thereafter. Solely for purposes of this paragraph (r), a transfer described in the preceding sentence shall be deemed to be a transfer occurring before March 13, 2009 to which the rules of §1.367(a)–8 (see 26 CFR part 1, revised April 1, 2006) apply. See paragraph (r)(2)(iii) of this section for the ability to apply the rules of this section with respect to gain recognition agreements filed for taxable years ending before March 13, 2009. The eleventh sentence of paragraph (a) and paragraphs (b)(1)(iv), (b)(1)(vi), (b)(1)(xiii), (d)(1), (j)(8), and (p) of this section will apply to gain recognition agreement documents that are required to be filed on or after November 19, 2014, as well as to requests for relief submitted on or after November 19, 2014.

(ii) *Transfers occurring before* March 13, 2009. For matters covered in this section for periods before March 13, 2009 but on or after March 7, 2007, the corresponding rules of §1.367(a)–8T (see 26 CFR part 1, revised April 1, 2007) apply. For matters covered in this section for periods before March 7, 2007 but on or after July 20, 1998, the corresponding rules of §1.367(a)–8 (see 26 CFR part 1, revised April 1, 2006) apply. For matters covered in this section for periods before July 20, 1998, the corresponding rules of §1.367(a)–3T(g) (see 26 CFR part 1, revised April 1, 1998) and Notice 87–85 (1987–2 CB 395) apply. In addition, if a U.S. transferor entered into a gain recognition agreement for transfers before July 20, 1998, then the rules of §1.367(a)–3T(g) (see 26 CFR part 1, revised April 1, 1998) continue to apply in lieu of this section in the event of any direct or indirect nonrecognition transfer of the same property. See also, §1.367(a)–3(h).

(2) *Applicability to transfers occurring before March 13, 2009* March 13, 2009—(i) *General rule.* Taxpayers may apply the rules of this regulation §1.367(a)–8 that were not included in §1.367(a)–8T (see 26 CFR part 1, revised April 1, 2007), to gain recognition agreements filed with respect to transfers of stock or securities for all open taxable years, if done consistently to all transfers. A U.S. transferor subject to section 877 and §1.367(a)–8T(d)(6) shall not apply the rules of this regulation to reach a contrary result. A taxpayer that failed to file a gain recognition agreement for a transfer, or to comply materially with any requirement of this section with respect to an existing gain recognition agreement, must obtain relief for reasonable cause for such failure under §1.367(a)–8T(e)(10) before applying the rules of this regulation §1.367(a)–8 that were not included in §1.367(a)–8T as permitted by this paragraph (r)(2). See paragraph (q)(2) of this section, *Examples 24* and *25* for illustrations of the rule provided by this paragraph (r)(2)(i).

(ii) *Taxable years ending before* March 13, 2009. Notwithstanding the requirements of §1.367(a)–8(d), any gain recognition agreement or other filing required by reason of electing to apply the rules of this regulation §1.367(a)–8 that were not included in §1.367(a)–8T, as permitted by this paragraph (r)(2), for a taxable year ending before March 13, 2009 shall be considered filed in accordance with the requirements of §1.367(a)–8(d), provided the gain recognition agreement or other filing is attached to an original or amended return for such taxable year. An amended return required to be filed by reason of electing to apply the rules of this regulation §1.367(a)–8 that were not included in §1.367(a)–8T, as permitted by this paragraph (r)(2), must be filed on or before August 10, 2009. A taxpayer that wishes to apply the rules of this regulation §1.367(a)–8 that were not included in §1.367(a)–8T, as permitted by this paragraph (r)(2), but that fails to meet the filing requirement described in the preceding sentence must request relief for reasonable cause under paragraph (p) of this section.

(iii) *Taxable years ending after effective date.* A taxpayer that entered into a gain recognition agreement to which §1.367(a)–8T (see 26 CFR part 1, revised April 1, 2007) applies may apply the rules of this section in a tax year ending on or after March 13, 2009 by attaching the agreement, certification, or other information related to such gain recognition agreement that the rules of this section require in accordance with the rules of this section and with the time and manner rules provided in §1.367(a)–8(d).

(3) *Applicability to requests for relief submitted before* November 19, 2014. The eleventh sentence of paragraph (a) and paragraphs (b)(1)(iv), (b)(1)(vi), (b)(1)(xiii), (d)(1), (j)(8), and (p) of this section will apply to requests for relief submitted before November 19, 2014 if—

(i) The statute of limitations on the assessment of tax has not expired for any year to which the request relates; and

(ii) The U.S. transferor resubmits the request under paragraph (p) of this section, notes on the request that the request is being submitted pursuant to this paragraph (r)(3), and acknowledges on the request that the last sentence of §1.6038B–1(g)(6) provides a special rule regarding the application of §1.6038B–1 to any transfer that is the subject of the request.

[T.D. 9446, 74 FR 6960, Feb. 11, 2009; 74 FR 10175, Mar. 10, 2009, as amended at T.D. 9446, 74 FR 13340, Mar. 27, 2009; T.D. 9614, 78 FR 17039, Mar. 19, 2013; T.D. 9704, 79 FR 68768, Nov. 19, 2014; 80 FR 167, Jan. 5, 2015; T.D. 9760, 81 FR 15169, Mar. 22, 20116]

§1.367(a)–9T Treatment of deemed section 351 exchanges pursuant to section 304(a)(1) (temporary).

(a) *Scope and general rule.* This section applies to the extent that, pursuant to section 304(a)(1), a United States person is treated as transferring stock of a domestic or foreign corporation to a foreign corporation (foreign acquiring corporation) in exchange for stock of the foreign acquiring corporation in a transaction to which section 351(a) applies (deemed section 351 exchange). Except to the extent provided in paragraph (b) of this section, a transfer of stock by a United States person to a foreign acquiring corporation in a deemed section 351 exchange is not subject to section 367(a)(1).

(b) *Special rule.* Notwithstanding paragraph (a) of this section, if the distribution received by the United States person in redemption of the stock of the foreign acquiring corporation deemed issued in the deemed section 351 exchange is applied against and reduces (in whole or in part), pursuant to section 301(c)(2), the basis of stock of the foreign acquiring corporation held by the United States person other than the stock deemed issued in the deemed section 351 exchange, the United States person shall recognize gain pursuant to this paragraph (b). The exceptions described in §1.367(a)–3(b)(1) and (c)(1) shall not apply to a transfer of stock described in paragraph (a) of this section. The amount of gain recognized by a United States person pursuant to this paragraph (b) shall equal the amount, if any, by which—

(1) The gain realized by the United States person with respect to the transferred stock in connection with the deemed section 351 exchange exceeds;

(2) The amount of the distribution received by the United States person in redemption of the stock of the foreign acquiring corporation deemed issued in the deemed section 351 exchange that is treated as a dividend under section 301(c)(1) and included in gross income by the United States person.

(c) *Ordering rule.* For purposes of paragraph (b)(1) of this section, the amount of gain realized by the United States person in connection with the deemed section 351 exchange shall be determined without regard to the amount of gain recognized by the United States person under paragraph (b) of this section.

(d) *Allocation of recognized gain.* Gain recognized by a United States person pursuant to paragraph (b) of this section shall be treated as recognized with respect to the stock transferred in the deemed section 351 exchange in proportion to the amount of gain realized by the United States person with respect to such stock. See §1.367(a)–1T(b)(4) for additional rules on the character, source, and adjustments relating to gain recognized under section 367(a).

(e) *Example.* The following example illustrates the rules of this section:

Example. (i) *Facts.* (A) USP, a domestic corporation, wholly owns FC1 and FC2, each a foreign corporation. USP, FC1 and FC2 use a calendar taxable year. The FC1 stock has a $40x basis and $100x fair market value. The FC2 stock has a $100x basis and $100x fair market value. As of December 31, year 1, FC1 has zero earnings and profits, and FC2 has $20x earnings and profits. On December 31, year 1, in a transaction described in section 304(a)(1), USP sells the FC1 stock to FC2 for $100x cash.

(B) Because USP wholly owns FC1 before the transactions and is treated, under section 318, as indirectly owning 100% of the FC1 stock after the transfer, under section 304(a)(1), USP and FC2 are treated in the same manner as if USP contributed the FC1 stock to FC2 in a deemed section 351 exchange in exchange solely for $100x of FC2 stock, and then FC2 redeemed for $100x cash its stock deemed issued to USP. Because USP wholly owns FC1 before the sale and is treated as owning 100% of FC1 after the sale, section 302(a) does not apply to the redemption. Instead, under section 302(d), the redemption is treated as a distribution to which section 301 applies. Pursuant to section 304(b)(2), $20x of the distribution is treated as a dividend from FC2. With respect to the remaining $80x, USP takes the position that $40x is applied against and reduces the basis of the FC2 stock issued in the deemed section 351 exchange, and $40x is applied against and reduces the basis of the FC2 stock held by USP prior to (and after) the transaction.

(ii) *Analysis.* Under paragraph (b) of this section, USP must recognize gain of $40x on its transfer of the FC1 stock to FC2 in the deemed section 351 exchange (the amount by which the $60x gain realized by USP on the deemed section 351 exchange with respect to the F1 stock exceeds the $20x dividend inclusion). Pursuant to paragraph (b) of this section, the exception under §1.367(a)–3(b) is not available to the transfer of the FC1 stock by USP to FC2 in the deemed section 351 exchange. Thus, USP cannot avoid gain recognition under paragraph (b) of this section by entering into a gain recognition agreement with respect to its transfer of the FC1 stock to FC2 in the deemed section 351 exchange. Under paragraph (d) of this section, the $40x gain recognized is allocated among the shares of FC1 stock transferred to FC2 in the deemed section 351 exchange in proportion to the gain realized by USP on the transfer of such shares. Under paragraph (c) of this section, the application of paragraph (b) of this section is determined prior to taking into account the $40x increase to the basis of the FC1 stock transferred by USP. Under section 362, the basis of the FC1 stock in the hands of FC2 is increased by $40x, the amount of gain recognized by the USP on the transfer of the FC1 stock under paragraph (b) of this section. Under section 358, the basis of the FC2 stock received by USP in the deemed section 351 exchange is similarly increased by $40x. See §1.367(a)–1T(b)(4). The $40x increase to the basis of the FC2 stock is taken into account before determining the consequences of the redemption of such stock under section 304(a)(1).

(f) *Effective/applicability date.* This section applies to transfers occurring on or after February 10, 2009. See §1.367(a)–3(a), as contained in 26 CFR part 1 revised as of April 1, 2008, for transfers occurring on or after February 21, 2006, and before February 10, 2009.

(g) *Expiration date.* This section expires on or before February 10, 2012.

[T.D. 9444, 74 FR 6826, Feb. 11, 2009; 74 FR 10175, Mar. 10, 2009]

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(2) Consequences of dividend characterization.
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(4) Examples.
(f) Deemed asset transfer and closing of taxable year in certain section 368(a)(1)(F) reorganizations.
(1) Scope.
(2) Deemed asset transfer.
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(h) Section 953(d) domestication elections.
(1) Effect of election.
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(1) Change in functional currency of a qualified business unit.
(i) Rule.
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(2) Previously taxed earnings and profits.
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(ii) Exchanging shareholder that is a foreign corporation.
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(k) Partnerships, trusts and estates.
(l) Additional definitions.
(1) Foreign income taxes.
(2) Post-1986 undistributed earnings.
(3) Post-1986 foreign income taxes.
(4) Pre-1987 accumulated profits.
(5) Pre-1987 foreign income taxes.
(6) Pre-1987 section 960 earnings and profits.
(7) Pre-1987 section 960 foreign income taxes.
(8) Earnings and profits.
(9) Pooling corporation.
(10) Nonpooling corporation.
(11) Separate category.
(12) Passive category.
(13) General category

§ 1.367(b)–3 Repatriation of foreign corporate assets in certain nonrecognition transactions.

(a) Scope.
(b) Exchange of stock owned directly by a United States shareholder or by certain foreign corporate shareholders.
(1) Scope.
(2) United States shareholder.
(3) Income inclusion.
(i) Inclusion of all earnings and profits amount.
(ii) Examples.
(iii) Recognition of exchange gain or loss with respect to capital. [Reserved]
(4) [Reserved]
(c) Exchange of stock owned by a United States person that is not a United States shareholder.
(1) Scope.
(2) Requirement to recognize gain.
(3) Election to include all earnings and profits amount.
(4) De minimis exception.
(5) Examples.
(d) Carryover of certain foreign taxes.
(1) Rule.
(2) Example.
(e) Net operating loss and capital loss carryovers.
(f) Carryover of earnings and profits.
(1) General rule.
(2) Previously taxed earnings and profits. [Reserved

§ 1.367(b)–4 Acquisition of foreign corporate stock or assets by a foreign corporation in certain nonrecognition transactions.

(a) Scope.
(b) Income inclusion.
(1) Exchange that results in loss of status as section 1248 shareholder.
(i) General rule.
(ii) Special rules.
(iii) Examples.
(2) Receipt by exchanging shareholder of preferred or other stock in certain instances.
(i) Rule.
(ii) Examples.
(3) Certain recapitalizations.
(c) Exclusion of deemed dividend from foreign personal holding company income.
(1) Rule.
(2) Example.
(d) Rules for subsequent exchanges.
(1) Rule.
(2) Example.

§ 1.367(b)–5 Distributions of stock described in section 355.

(a) In general.
(1) Scope.
(2) Treatment of distributees as exchanging shareholders.
(b) Distribution by a domestic corporation.
(1) General rule.
(2) Section 367(e) transactions.
(3) Determining whether distributees are individuals.
(4) Applicable cross-references.
(c) Pro rata distribution by a controlled foreign corporation.
(1) Scope.
(2) Adjustment to basis in stock and income inclusion.
(3) Interaction with § 1.367(b)–2(e)(3)(ii).
(4) Basis redistribution.
(d) Non-pro rata distribution by a controlled foreign corporation.

(1) Scope.
(2) Treatment of certain shareholders as distributees.
(3) Inclusion of excess section 1248 amount by exchanging shareholder.
(4) Interaction with §1.367(b)–2(e)(3)(ii).
(i) Limited application.
(ii) Interaction with predistribution amount.
(e) Definitions.
(1) Predistribution amount.
(2) Postdistribution amount.
(f) Exclusion of deemed dividend from foreign personal holding company income.
(g) Examples.

§1.367(b)–6 Effective/applicability dates and coordination rules.

(a) Effective/applicability dates.
(1) In general.
(2) Exception.
(b) Certain recapitalizations described in §1.367(b)–4(b)(3).
(c) Use of reasonable method to comply with prior published guidance.
(1) Prior exchanges.
(2) Future exchanges.
(d) Effect of removal of attribution rules.

§1.367(b)–7 Carryover of earnings and profits and foreign income taxes in certain foreign-to-foreign nonrecognition transactions.

(a) Scope.
(b) General rules.
(1) Non-previously taxed earnings and profits and related taxes.
(2) Previously taxed earnings and profits. [Reserved]
(c) Ordering rule for post-transaction distributions.
(1) If foreign surviving corporation is a pooling corporation.
(2) If foreign surviving corporation is a nonpooling corporation.
(d) Post-1986 pool.
(1) In general.
(i) Qualifying earnings and taxes.
(ii) Carryover rule.
(2) Hovering deficit.
(i) In general.
(ii) Offset rule.
(iii) Related taxes.
(3) Examples.
(e) Pre-pooling annual layers.
(1) If foreign surviving corporation is a pooling corporation.
(i) Qualifying earnings and taxes.
(ii) Carryover rule.
(iii) Deficits.
(A) In general.
(B) Aggregate positive pre-1987 accumulated profits.
(C) Aggregate deficit in pre-1987 accumulated profits.
(D) Deficit and positive separate categories within annual layers
(iv) Pre-1987 section 960 earnings and profits and foreign income taxes.
(v) Examples.
(2) If foreign surviving corporation is a nonpooling corporation.
(i) Qualifying earnings and taxes.
(ii) Carryover rule.
(iii) Deficits.
(A) In general.
(B) Aggregate positive pre-1987 accumulated profits.
(C) Aggregate deficit in pre-1987 accumulated profits.
(D) Deficit and positive separate categories within annual layers.
(iv) Pre-1987 section 960 earnings and profits and foreign income taxes.
(v) Examples.
(f) Special rules.
(1) Treatment of deficit.
(i) General rule.
(ii) Exceptions.
(iii) Examples.
(2) Reconciling taxable years.
(3) Post-transaction change of status.
(4) Ordering rule for multiple hovering deficits.
(i) Rule.
(ii) Example.
(5) Pro rata rule for earnings and deficits during transaction year.
(g) Effective date.

§1.367(b)–8 Allocation of earnings and profits and foreign income taxes in certain foreign corporate separations. [Reserved]

§1.367(b)–9 Special rule for F reorganizations and similar transactions.

(a) Scope.
(b) Hovering deficit rules inapplicable.
(c) Foreign divisive transactions. [Reserved]
(d) Examples.
(e) Effective date.

§1.367(b)–10 Acquisition of parent stock or securities for property in triangular reorganizations.

(a) In general.
(1) Scope.
(2) Exceptions.
(3) Definitions.
(b) General rules.
(1) Deemed distribution.
(2) Deemed contribution.
(3) Timing of deemed distribution and deemed contribution.
(4) Application of other provisions.
(5) Example.
(c) Collateral adjustments.
(1) Deemed distribution.
(2) Deemed contribution.
(d) Anti-abuse rule.
(e) Effective/applicability date.

§ 1.367(b)–12 Subsequent treatment of amounts attributed or included in income.

(a) In general.
(b) Applicable rules.
(c) Effective date.

§ 1.367(b)–13 Special rules for determining basis and holding period.

(a) Scope and definitions.
(1) Scope.
(2) Definitions.
(b) Determination of basis for exchanges of foreign stock or securities under section 354 or 356.
(c) Determination of basis and holding period for triangular reorganizations.
(1) Application.
(2) Basis and holding period rules.
(i) Portions attributable to S stock.
(ii) Portions attributable to T stock.
(d) Special rules applicable to divided shares of stock.
(1) In general.
(2) Pre-exchange earnings and profits.
(3) Post-exchange earnings and profits.
(e) Examples.
(f) Effective date.

[T.D. 8862, 65 FR 3596, Jan. 24, 2000; 65 FR 66501, Nov. 6, 2000, as amended by T.D. 8937, 66 FR 2257, Jan. 11, 2001; T.D. 9273, 71 FR 44984, Aug. 8, 2006; T.D. 9526, 76 FR 28893, May 19, 2011; T.D. 9614, 78 FR 17039, Mar. 19, 2013]

EDITORIAL NOTE: At 76 FR 28893, May 19, 2011 §1.376(b)–0 was amended by redesignating the entries for (d)(3)(iii)(A) and (B) as entries for (d)(3)(ii)(A) and (B); however, the amendment could not be incorporated due to inaccurate amendatory instruction.

§ 1.367(b)–1 Other transfers.

(a) *Scope.* The regulations promulgated under section 367(b) (the section 367(b) regulations) set forth rules regarding the proper inclusions and adjustments that must be made as a result of an exchange described in section 367(b) (a section 367(b) exchange). A section 367(b) exchange is any exchange described in section 332, 351, 354, 355, 356 or 361, with respect to which the status of a foreign corporation as a corporation is relevant for determining the extent to which income shall be recognized or for determining the effect of the transaction on earnings and profits, basis of stock or securities, basis of assets, or other relevant tax attributes. For rules coordinating the concurrent application of sections 367(a) and (b), see §1.367(a)–3(b)(2).

(b) *General rules*—(1) *Rules.* The following general rules apply under the section 367(b) regulations—

(i) A foreign corporation in a section 367(b) exchange is considered to be a corporation and, as a result, all of the related provisions (*e.g.*, section 381) shall apply, except to the extent provided in the section 367(b) regulations; and

(ii) Nothing in the section 367(b) regulations shall permit—

(A) The nonrecognition of income that would otherwise be required to be recognized under another provision of the Internal Revenue Code or the regulations thereunder; or

(B) The recognition of a loss or deduction that would otherwise not be recognized under another provision of the Internal Revenue Code or the regulations thereunder.

(2) *Example.* The following example illustrates the rules of this paragraph (b):

Example. (i) *Facts.* DC, a domestic corporation, owns 90 percent of P, a partnership. The remaining 10 percent of P is owned by a person unrelated to DC. P owns all of the outstanding stock of FC, a controlled foreign corporation. FC liquidates into P.

(ii) *Result.* FC's liquidation is not a transaction described in section 332. Nothing in the section 367(b) regulations, including §1.367(b)–2(k), permits FC's liquidation to qualify as a liquidation described in section 332.

(c) *Notice Required*—(1) *In general.* A notice under this paragraph (c) (section 367(b) notice) must be filed with regard to any person described in paragraph (c)(2) of this section. A section 367(b) notice must be filed in the time and manner described in paragraph (c)(3) of this section and must include the information described in paragraph (c)(4) of this section.

(2) *Persons subject to section 367(b) notice.* The following persons are described in this paragraph (c)(2)—

(i) A shareholder described in §1.367(b)–3(b)(1) that realizes income in a transaction described in §1.367(b)–3(a);

(ii) A shareholder that makes the election described in §1.367(b)–3(c)(3);

(iii) A shareholder described in §1.367(b)–4(b)(1)(i)(A)(*1*) or (*2*) that realizes income in a transaction described in §1.367(b)–4(a);

(iv) A shareholder that realizes income in a transaction described in §1.367(b)–5(c) or 1.367(b)–5(d) and that is either—

(A) A section 1248 shareholder of the distributing or controlled corporation; or

(B) A foreign corporation with one or more shareholders that are described in paragraph (c)(2)(iv)(A) of this section; and

(v) A foreign surviving corporation described in §1.367(b)–7(a).

(3) *Time and manner for filing notice*—(i) *United States persons described in §1.367(b)–1(c)(2).* A United States person described in paragraph (c)(2) of this section must file a section 367(b) notice attached to a timely filed Federal tax return (including extensions) for the person's taxable year in which income is realized in the section 367(b) exchange. In the case of a shareholder that makes the election described in §1.367(b)–3(c)(3), notification of such election must be sent to the foreign acquired corporation (or its successor in interest) on or before the date the section 367(b) notice is filed, so that appropriate corresponding adjustments can be made in accordance with the rules of §1.367(b)–2(e).

(ii) *Foreign corporations described in §1.367(b)–1(c)(2).* Each United States person listed in this paragraph (c)(3)(ii) must file a section 367(b) notice with regard to a foreign corporation described in paragraph (c)(2) of this section. Such notice must be attached to a timely filed Federal tax return (including extensions) for the United States person's taxable year in which income is realized in the section 367(b) exchange and, if the United States person is required to file a Form 5471 (Information Return of U.S. Persons With Respect to Certain Foreign Corporations), the section 367(b) notice must be attached to the Form 5471. The following persons are listed in this paragraph (c)(3)(ii)—

(A) United States shareholders (as defined in §1.367(b)–3(b)(2)) of foreign corporations described in paragraph (c)(2)(i) or (v) of this section; and

(B) Section 1248 shareholders of foreign corporations described in paragraph (c)(2)(iii) or (iv) of this section.

(4) *Information required.* Except as provided in paragraph (c)(5) of this section, a section 367(b) notice shall include the following information—

(i) A statement that the exchange is a section 367(b) exchange;

(ii) A complete description of the exchange;

(iii) A description of any stock, securities or other consideration transferred or received in the exchange;

(iv) A statement that describes any amount (or amounts) required, under the section 367(b) regulations, to be taken into account as income or loss or as an adjustment (including an adjustment under §1.367(b)–7 or 1.367(b)–9) to basis, earnings and profits, or other tax attributes as a result of the exchange;

(v) Any information that is or would be required to be furnished with a Federal income tax return pursuant to regulations under section 332, 351, 354, 355, 356, 361, 368, or 381 (whether or not a Federal income tax return is required to be filed), if such information has not otherwise been provided by the person filing the section 367(b) notice;

(vi) Any information required to be furnished with respect to the exchange under sections 6038, 6038A, 6038B, 6038C or 6046, or the regulations under those sections, if such information has not otherwise been provided by the person filing the section 367(b) notice; and

(vii) If applicable, a statement that the shareholder is making the election described in §1.367(b)–3(c)(3). This statement must include—

(A) A copy of the information the shareholder received from the foreign acquired corporation (or its successor in interest) establishing and substantiating the shareholder's all earnings and profits amount with respect to the shareholder's stock in the foreign acquired corporation; and

(B) A representation that the shareholder has notified the foreign acquired corporation (or its successor in interest) that the shareholder is making the election described in §1.367(b)–3(c)(3).

(5) *Abbreviated notice provision for shareholders that make the election described in §1.367(b)–3(c)(3).* In the case of a foreign acquired corporation that has never had earnings and profits that would result in any shareholder having an all earnings and profits amount, a

shareholder making the election described in §1.367(b)–3(c)(3) may satisfy the information requirements of paragraph (c)(4) of this section by filing a section 367(b) notice that includes—

(i) A statement from the foreign acquired corporation (or its successor in interest) that the foreign acquired corporation has never had any earnings and profits that would result in any shareholder having an all earnings and profits amount; and

(ii) The information described in paragraphs (c)(4) (i) through (iii) of this section.

(6) *Supplemental published guidance.* The section 367(b) notice requirements may be updated or amended by revenue procedure or other published guidance.

[T.D. 8862, 65 FR 3597, Jan. 24, 2000; 65 FR 66501, Nov. 6, 2000, as amended by T.D. 9243, 71 FR 4288, Jan. 26, 2006; T.D. 9273, 71 FR 44894, Aug. 8, 2006]

§ 1.367(b)–2 Definitions and special rules.

(a) *Controlled foreign corporation.* The term *controlled foreign corporation* means a controlled foreign corporation as defined in section 957 (taking into account section 953(c)).

(b) *Section 1248 shareholder.* The term *section 1248 shareholder* means any United States person that satisfies the ownership requirements of section 1248 (a)(2) or (c)(2) with respect to a foreign corporation.

(c) *Section 1248 amount*—(1) *Rule.* The term *section 1248 amount* with respect to stock in a foreign corporation means the net positive earnings and profits (if any) that would have been attributable to such stock and includible in income as a dividend under section 1248 and the regulations thereunder if the stock were sold by the shareholder. In the case of a transaction in which the shareholder is a foreign corporation (foreign shareholder), the following additional rules shall apply—

(i) The foreign shareholder shall be deemed to be a United States person for purposes of this paragraph (c), except that the foreign shareholder shall not be considered a United States person for purposes of determining whether the stock owned by the foreign shareholder is stock of a controlled foreign corporation; and

(ii) The foreign shareholder's holding period in the stock of the foreign corporation shall be determined by reference to the period that the foreign shareholder's section 1248 shareholders held (directly or indirectly) an interest in the foreign corporation. This paragraph (c)(1)(ii) applies in addition to the section 1248 regulations' incorporation of section 1223 holding periods. See §1.1248–8.

(2) *Examples.* The following examples illustrate the rules of this paragraph (c):

Example 1. (i) *Facts.* DC, a domestic corporation, owns all of the outstanding stock of FC1, a controlled foreign corporation (CFC). FC1 owns all of the outstanding stock of FC2, a CFC. DC has always owned all of the stock of FC1, and FC1 has always owned all of the stock of FC2.

(ii) *Result.* Under this paragraph (c), DC's section 1248 amount with respect to its FC1 stock is computed by reference to all of FC1's and FC2's earnings and profits. See section 1248(c)(2). Because FC1's section 1248 shareholder (DC) always indirectly held all of the stock of FC2, FC1's section 1248 amount with respect to its FC2 stock is computed by reference to all of FC2's earnings and profits.

Example 2. (i) *Facts.* DC, a domestic corporation, owns 40 percent of the outstanding stock of FC1, a foreign corporation. The other 60 percent of FC1 stock is owned (directly and indirectly) by foreign persons that are unrelated to DC. FC1 owns all of the outstanding stock of FC2, a foreign corporation. On January 1, 2001, DC purchases the remaining 60 percent of FC1 stock.

(ii) *Result.* Under this paragraph (c), DC's section 1248 amount with respect to its FC1 stock is computed by reference to FC1's and FC2's earnings and profits that accumulated on or after January 1, 2001, the date FC1 and FC2 became controlled foreign corporations (CFCs). See section 1248(a). Because FC1 is not considered a United States person for purposes of determining whether FC2 is a CFC, FC1's section 1248 amount with respect to its FC2 stock is computed by reference to FC2's earnings and profits that accumulated on or after January 1, 2001, the date FC2 became an actual CFC.

Example 3. (i) *Facts.* FC1, a foreign corporation, owns all of the outstanding stock of FC2, a foreign corporation. DC is a domestic corporation that is unrelated to FC1, FC2, and their direct and indirect owners. On January 1, 2001, DC purchases all of the outstanding stock of FC1.

(ii) *Result.* Under this paragraph (c), DC's section 1248 amount with respect to its FC1 stock is computed by reference to FC1's and

FC2's earnings and profits that accumulated on or after January 1, 2001, the first day DC held the stock of FC1. See section 1248(a). FC1's section 1248 amount with respect to its FC2 stock is computed by reference to FC2's earnings and profits that accumulated on or after January 1, 2001, the first day FC1's section 1248 shareholder (DC) indirectly held the stock of FC2.

(d) *All earnings and profits amount*—(1) *General rule.* The term *all earnings and profits amount* with respect to stock in a foreign corporation means the net positive earnings and profits (if any) determined as provided under paragraph (d)(2) of this section and attributable to such stock as provided under paragraph (d)(3) of this section. The all earnings and profits amount shall be determined without regard to the amount of gain that would be realized on a sale or exchange of the stock of the foreign corporation.

(2) *Rules for determining earnings and profits*—(i) *Domestic rules generally applicable.* For purposes of this paragraph (d), except as provided in sections 312(k)(4) and (n)(8), 964 and 986, the earnings and profits of a foreign corporation for any taxable year shall be determined according to principles substantially similar to those applicable to domestic corporations.

(ii) *Certain adjustments to earnings and profits.* Notwithstanding paragraph (d)(2)(i) of this section, for purposes of this paragraph (d), the earnings and profits of a foreign corporation for any taxable year shall not include the amounts specified in section 1248(d). In the case of amounts specified in section 1248(d)(4), the preceding sentence requires that the earnings and profits for any taxable year be decreased by the net positive amount (if any) of earnings and profits attributable to activities described in section 1248(d)(4), and increased by the net reduction (if any) in earnings and profits attributable to activities described in section 1248(d)(4).

(iii) *Effect of section 332 liquidating distribution.* The all earnings and profits amount with respect to stock of a corporation that distributes all of its property in a liquidation described in section 332 shall be determined without regard to the adjustments prescribed by section 312(a) and (b) resulting from the distribution of such property in liquidation, except that gain or loss realized by the corporation on the distribution shall be taken into account to the extent provided in section 312(f)(1). See §1.367(b)–3(b)(3)(ii) *Example 3.*

(3) *Amount attributable to a block of stock*—(i) *Application of section 1248 principles*—(A) *In general*—(*1*) *Rule.* The all earnings and profits amount with respect to stock of a foreign corporation is determined according to the attribution principles of section 1248 and the regulations thereunder. The attribution principles of section 1248 shall apply without regard to the requirements of section 1248 that are not relevant to the determination of a shareholder's pro rata portion of earnings and profits. Thus, for example, the all earnings and profits amount is determined without regard to whether the foreign corporation was a controlled foreign corporation at any time during the five years preceding the section 367(b) exchange in question, without regard to whether the shareholder owned a 10 percent or greater interest in the stock, and without regard to whether the earnings and profits of the foreign corporation were accumulated in post-1962 taxable years or while the corporation was a controlled foreign corporation.

(*2*) *Example.* The following example illustrates the rules of this paragraph (d)(3)(i)(A):

Example. (i) *Facts.* On January 1, 2001, DC, a domestic corporation, purchases 9 percent of the outstanding stock of FC, a foreign corporation. On January 1, 2002, DC purchases an additional 1 percent of FC stock. On January 1, 2003, DC exchanges its stock in FC in a section 367(b) exchange in which DC is required to include the all earnings and profits amount in income. FC was not a controlled foreign corporation during the entire period DC held its FC stock.

(ii) *Result.* The all earnings and profits amount with respect to DC's stock in FC is computed by reference to 9 percent of FC's earnings and profits from January 1, 2001, through December 31, 2001, and by reference to 10 percent of FC's earnings and profits from January 1, 2002, through January 1, 2003.

(B) *Foreign shareholders.* In the case of a transaction in which the exchanging shareholder is a foreign corporation (foreign shareholder), the following additional rules shall apply—

(*1*) The attribution principles of section 1248 shall apply without regard to whether the person directly owning the stock is a United States person; and

(*2*) The foreign shareholder's holding period in the stock of the foreign acquired corporation shall be determined by reference to the period that the foreign shareholder's United States shareholders (as defined in §1.367(b)–3(b)(2)) held (directly or indirectly) an interest in the foreign acquired corporation. This paragraph (d)(3)(i)(B)(*2*) applies in addition to the section 1248 regulations' incorporation of section 1223 holding periods. See §1.1248–8.

(ii) *Exclusion of lower-tier earnings.* In applying the attribution principles of section 1248 and the regulations thereunder to determine the all earnings and profits amount with respect to stock of a foreign corporation, the earnings and profits of subsidiaries of the foreign corporation shall not be taken into account notwithstanding section 1248(c)(2).

(e) *Treatment of deemed dividends*—(1) *In general.* In certain circumstances these regulations provide that an exchanging shareholder shall include an amount in income as a deemed dividend. This paragraph provides rules for the treatment of the deemed dividend.

(2) *Consequences of dividend characterization.* A deemed dividend described in paragraph (e)(1) of this section shall be treated as a dividend for purposes of the Internal Revenue Code. The deemed dividend shall be considered as paid out of the earnings and profits with respect to which the amount of the deemed dividend was determined. Thus, for example, a deemed dividend that is determined by reference to the all earnings and profits amount or the section 1248 amount will never be considered as paid out of (and therefore will never reduce) earnings and profits specified in section 1248(d), because such earnings and profits are excluded in computing the all earnings and profits amount (under paragraph (d)(2)(ii) of this section) and the section 1248 amount (under section 1248(d) and paragraph (c)(1) of this section). If the deemed dividend is determined by reference to the earnings and profits of a foreign corporation that is owned indirectly (*i.e.*, through one or more tiers of intermediate owners) by the person that is required to include the deemed dividend in income, the deemed dividend shall be considered as having been paid by such corporation to such person through the intermediate owners, rather than directly to such person.

(3) *Ordering rules.* In the case of an exchange of stock in which the exchanging shareholder is treated as receiving a deemed dividend from a foreign corporation, the following ordering rules concerning the timing, treatment, and effect of such a deemed dividend shall apply. See also paragraph (j)(2) of this section.

(i) For purposes of the section 367(b) regulations, the gain realized by an exchanging shareholder shall be determined before increasing (as provided in paragraph (e)(3)(ii) of this section) the basis in the stock of the foreign corporation by the amount of the deemed dividend.

(ii) Except as provided in paragraph (e)(3)(i) of this section, the deemed dividend shall be considered to be received immediately before the exchanging shareholder's receipt of consideration for its stock in the foreign corporation, and the shareholder's basis in the stock exchanged shall be increased by the amount of the deemed dividend. Such basis increase shall be taken into account before determining the gain otherwise recognized on the exchange (for example, under section 356), the basis that the exchanging shareholder takes in the property that it receives in the exchange (under section 358(a)(1)), and the basis that the transferee otherwise takes in the transferred stock (under section 362).

(iii) Except as provided in paragraph (e)(3)(i) of this section, the earnings and profits of the appropriate foreign corporation shall be reduced by the deemed dividend amount before determining the consequences of the recognition of gain in excess of the deemed dividend amount (for example, under section 356(a)(2) or sections 356(a)(1) and 1248).

(4) *Examples.* The following examples illustrate the rules of this paragraph (e):

Example 1. DC, a domestic corporation, exchanges stock in FC, a foreign corporation,

in a section 367(b) exchange in which DC includes the all earnings and profits amount in income as a deemed dividend. Under paragraph (e)(2) of this section, a deemed dividend is treated as a dividend for purposes of the Internal Revenue Code. As a result, if the requirements of section 902 are met, DC may qualify for a deemed paid foreign tax credit with respect to the deemed dividend that it receives from FC.

Example 2. DC, a domestic corporation, exchanges stock in FC1, a foreign corporation that is a controlled foreign corporation, in a transaction in which DC is required to include the section 1248 amount in income as a deemed dividend. A portion of the section 1248 amount is determined by reference to the earnings and profits of FC1 (the upper-tier portion of the section 1248 amount), and the remainder of the section 1248 amount is determined by reference to the earnings and profits of FC2, which is a wholly owned foreign subsidiary of FC1 (the lower-tier portion of the section 1248 amount). Under paragraph (e)(2) of this section, DC computes its deemed paid foreign tax credit as if the lower-tier portion of the section 1248 amount were distributed as a dividend by FC2 to FC1, and as if such portion and the upper-tier portion of the section 1248 amount were then distributed as a dividend by FC1 to DC.

Example 3. DC, a domestic corporation, exchanges stock in FC, a foreign corporation that is a controlled foreign corporation, in a transaction in which DC realizes gain of $100 (prior to the application of the section 367(b) regulations). In connection with the transaction, DC is required to include $40 in income as a deemed dividend under the section 367(b) regulations. In addition to receiving property permitted to be received under section 354 without the recognition of gain, DC also receives cash in the amount of $70. Under paragraph (e)(3) of this section, the $40 deemed dividend increases DC's basis in its FC stock before determining the gain to be recognized under section 356. Thus, in applying section 356, DC is considered to realize $60 of gain on the exchange, all of which is recognized under section 356(a)(1).

(f) *Deemed asset transfer and closing of taxable year in certain section 368(a)(1)(F) reorganizations*—(1) *Scope.* This paragraph applies to a reorganization described in section 368(a)(1)(F) in which the transferor corporation is a foreign corporation.

(2) *Deemed asset transfer.* In a reorganization described in paragraph (f)(1) of this section, there is considered to exist—

(i) A transfer of assets by the foreign transferor corporation to the acquiring corporation in exchange for stock (or stock and securities) of the acquiring corporation and the assumption by the acquiring corporation of the foreign transferor corporation's liabilities;

(ii) A distribution of such stock (or stock and securities) by the foreign transferor corporation to its shareholders (or shareholders and security holders); and

(iii) An exchange by the foreign transferor corporation's shareholders (or shareholders and security holders) of their stock (or stock and securities) for stock (or stock and securities) of the acquiring corporation.

(3) *Other applicable rules.* For purposes of this paragraph (f), it is immaterial that the applicable foreign or domestic law treats the acquiring corporation as a continuation of the foreign transferor corporation.

(4) *Closing of taxable year.* In a reorganization described in paragraph (f)(1) of this section, the taxable year of the foreign transferor corporation shall end with the close of the date of the transfer and, except as otherwise required under the Internal Revenue Code (*e.g.* section 1502 and the regulations thereunder), the taxable year of the acquiring corporation shall end with the close of the date on which the transferor's taxable year would have ended but for the occurrence of the reorganization if—

(i) The acquiring corporation is a domestic corporation; or

(ii) The foreign transferor corporation has effectively connected earnings and profits (as defined in section 884(d)) or accumulated effectively connected earnings and profits (as defined in section 884(b)(2)(B)(ii)).

(g) *Stapled stock under section 269B.* For rules addressing the deemed conversion of a foreign corporation to a domestic corporation under section 269B, see § 1.269B–1(c).

(h) *Section 953(d) domestication elections*—(1) *Effect of election.* A foreign corporation that elects under section 953(d) to be treated as a domestic corporation shall be treated for purposes of section 367(b) as transferring, as of the first day of the first taxable year for which the election is effective, all of its assets to a domestic corporation in a reorganization described in section

368(a)(1)(F). Notwithstanding paragraph (d) of this section, for purposes of determining the consequences of the reorganization under §1.367(b)–3, the all earnings and profits amount shall not be considered to include earnings and profits accumulated in taxable years beginning before January 1, 1988.

(2) *Post-election exchanges.* For purposes of applying section 367(b) to post-election exchanges with respect to a corporation that has made a valid election under section 953(d) to be treated as a domestic corporation, such corporation shall be treated as a domestic corporation as to earnings and profits that were taken into account at the time of the section 953(d) election or which accrue after such election, and shall be treated as a foreign corporation as to earnings and profits accumulated in taxable years beginning before January 1, 1988. Thus, for example, if the section 953(d) corporation subsequently transfers its assets to a domestic corporation (other than another section 953(d) corporation) in a transaction described in section 381(a), the rules of §1.367(b)–3 shall apply to such transaction to the extent of the section 953(d) corporation's earnings and profits accumulated in taxable years beginning before January 1, 1988.

(i) *Section 1504(d) elections.* An election under section 1504(d), which permits certain foreign corporations to be treated as domestic corporations, is treated as a transfer of property to a domestic corporation and will generally constitute a reorganization described in section 368(a)(1)(F). However, if an election under section 1504(d) is made with respect to a foreign corporation from the first day of the foreign corporation's existence, then the foreign corporation shall be treated as a domestic corporation, and the section 367(b) regulations will not apply.

(j) *Sections 985 through 989*—(1) *Change in functional currency of a qualified business unit*—(i) *Rule.* If, as a result of a section 367(b) exchange described in section 381(a), a qualified business unit (as defined in section 989(a)) (QBU) has a different functional currency determined under the rules of section 985(b) than it used prior to the transaction, then the QBU shall be deemed to have automatically changed its functional currency immediately prior to the transaction. A QBU that is deemed to change its functional currency pursuant to this paragraph (j) must make the adjustments described in §1.985–5.

(ii) *Example.* The following example illustrates the rule of this paragraph (j)(1):

Example. (i) *Facts.* DC, a domestic corporation, owns 100 percent of FC1, a foreign corporation. FC1 owns and operates a qualified business unit (QBU) (B1) in France, whose functional currency is the euro. FC2, an unrelated foreign corporation, owns and operates a QBU (B2) in France, whose functional currency is the dollar. FC2 acquires FC1's assets (including B1) in a reorganization described in section 368(a)(1)(C). As a part of the reorganization, B1 and B2 combine their operations into one QBU. Applying the rules of section 985(b), the functional currency of the combined operations of B1 and B2 is the euro.

(ii) *Result.* FC2's acquisition of FC1's assets is a section 367(b) exchange that is described in section 381(a). Because the functional currency of the combined operations of B1 and B2 after the exchange is the euro, B2 is deemed to have automatically changed its functional currency to the euro immediately prior to the section 367(b) exchange. B2 must make the adjustments described in §1.985–5.

(2) *Previously taxed earnings and profits*—(i) *Exchanging shareholder that is a United States person.* If an exchanging shareholder that is a United States person is required to include in income either the all earnings and profits amount or the section 1248 amount under the provisions of §1.367(b)–3 or 1.367(b)–4, then immediately prior to the exchange, and solely for the purpose of computing exchange gain or loss under section 986(c), the exchanging shareholder shall be treated as receiving a distribution of previously taxed earnings and profits from the appropriate foreign corporation that is attributable (under the principles of section 1248) to the exchanged stock. If an exchanging shareholder that is a United States person is a distributee in an exchange described in §1.367(b)–5(c) or (d), then immediately prior to the exchange, and solely for the purpose of computing exchange gain or loss under section 986(c), the exchanging shareholder shall be treated as receiving a distribution of previously taxed earnings and profits from the appropriate foreign corporation to the extent such

shareholder has a diminished interest in such previously taxed earnings and profits after the exchange. The exchange gain or loss recognized under this paragraph (j)(2)(i) will increase or decrease the exchanging shareholder's adjusted basis in the stock of the foreign corporation, including for purposes of computing gain or loss realized with respect to the stock on the transaction. The exchanging shareholder's dollar basis with respect to each account of previously taxed income shall be increased or decreased by the exchange gain or loss recognized.

(ii) *Exchanging shareholder that is a foreign corporation.* If an exchanging shareholder that is a foreign corporation is required to include in income either the all earnings and profits amount or the section 1248 amount under the provisions of §1.367(b)–3 or 1.367(b)–4, then, immediately prior to the exchange, the exchanging shareholder shall be treated as receiving a distribution of previously taxed earnings and profits from the appropriate foreign corporation that is attributable (under the principles of section 1248) to the exchanged stock. If an exchanging shareholder that is a foreign corporation is a distributee in an exchange described in §1.367(b)–5(c) or (d), then the exchanging shareholder shall be treated as receiving (immediately prior to the exchange) a distribution of previously taxed earnings and profits from the appropriate foreign corporation. Such distribution shall be measured by the extent to which the exchanging shareholder's direct or indirect United States shareholders (as defined in section 951(b)) have a diminished interest in such previously taxed earnings and profits after the exchange.

(3) *Other rules.* See sections 985 through 989 for other currency rules that may apply in connection with a section 367(b) exchange.

(k) *Partnerships, trusts and estates.* In applying the section 367(b) regulations, stock of a corporation that is owned by a foreign partnership, trust or estate shall be considered as owned proportionately by its partners, owners, or beneficiaries under the principles of §1.367(e)–1(b)(2). Stock owned by an entity that is disregarded as an entity separate from its owner under §301.7701–3 is owned directly by the owner of such entity. In applying §1.367(b)–5(b), the principles of §1.367(e)–1(b)(2) shall also apply to a domestic partnership, trust or estate.

(l) *Additional definitions*—(1) *Foreign income taxes.* The term *foreign income taxes* has the meaning set forth in §1.902–1(a)(7).

(2) *Post-1986 undistributed earnings.* The term *post-1986 undistributed earnings* has the meaning set forth in §1.902–1(a)(9).

(3) *Post-1986 foreign income taxes.* The term *post-1986 foreign income taxes* has the meaning set forth in §1.902–1(a)(8).

(4) *Pre-1987 accumulated profits.* The term *pre-1987 accumulated profits* means the earnings and profits described in §1.902–1(a)(10)(i), computed in accordance with the rules of §1.902–1(a)(10)(ii).

(5) *Pre-1987 foreign income taxes.* The term *pre-1987 foreign income taxes* has the meaning set forth in §1.902–1(a)(10)(iii).

(6) *Pre-1987 section 960 earnings and profits.* The term *pre-1987 section 960 earnings and profits* means the earnings and profits of a foreign corporation accumulated in taxable years beginning before January 1, 1987, computed under §1.964–1(a) through (e), and translated into the functional currency (as determined under section 985) of the foreign corporation at the spot rate on the first day of the foreign corporation's first taxable year beginning after December 31, 1986. For further guidance, see Notice 88–70 (1988–2 C.B. 369, 370) (see also §601.601(d)(2) of this chapter). The term pre-1987 section 960 earnings and profits does not include earnings and profits that represent previously taxed earnings and profits described in section 959.

(7) *Pre-1987 section 960 foreign income taxes.* The term *pre-1987 section 960 foreign income taxes* means the foreign income taxes related to pre-1987 section 960 earnings and profits, determined in accordance with the principles of §1.902–1(a)(10)(iii), except that the U.S. dollar amounts of pre-1987 section 960 foreign income taxes are determined by reference to the exchange rates in effect when the taxes were paid or accrued.

(8) *Earnings and profits.* For purposes of §§1.367(b)–7 and 1.367(b)–9, the term

earnings and profits means post-1986 undistributed earnings, pre-1987 accumulated profits, and pre-1987 section 960 earnings and profits.

(9) *Pooling corporation.* The term *pooling corporation* means a foreign corporation with respect to which the requirements of section 902(c)(3)(B) have been met in the current taxable year or any prior taxable year.

(10) *Nonpooling corporation.* The term *nonpooling corporation* means a foreign corporation that is not a pooling corporation.

(11) *Separate category.* The term *separate category* has the meaning set forth in section 904(d)(1), and shall also include any other category of income to which section 904(a), (b), and (c) are applied separately under any other provision of the Internal Revenue Code (e.g., sections 56(g)(4)(C)(iii)(IV), 245(a)(10), 865(h), 901(j), and 904(h)(10) (or section 904(g)(10) for taxable years beginning on or before December 31, 2006).

(12) *Passive category.* The term *passive category* means the separate category that includes income described in section 904(d)(1)(A).

(13) *General category.* The term *general category* means the separate category that includes income described in section 904(d)(1)(B) (or section 904(d)(1)(I) for taxable years beginning on or before December 31, 2006).

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§ 1.367(b)–3 Repatriation of foreign corporate assets in certain nonrecognition transactions.

(a) *Scope.* This section applies to an acquisition by a domestic corporation (the domestic acquiring corporation) of the assets of a foreign corporation (the foreign acquired corporation) in a liquidation described in section 332 or an asset acquisition described in section 368(a)(1).

(b) *Exchange of stock owned directly by a United States shareholder or by certain foreign corporate shareholders—(1) Scope.* This paragraph (b) applies in the case of an exchanging shareholder that is either—

(i) A United States shareholder of the foreign acquired corporation; or

(ii) A foreign corporation with respect to which there are one or more United States shareholders.

(2) *United States shareholder.* For purposes of this section (and for purposes of the other section 367(b) regulation provisions that specifically refer to this paragraph (b)(2)), the term *United States shareholder* means any shareholder described in section 951(b) (without regard to whether the foreign corporation is a controlled foreign corporation), and also any shareholder described in section 953(c)(1)(A) (but only if the foreign corporation is a controlled foreign corporation as defined in section 953(c)(1)(B) subject to the rules of section 953(c)).

(3) *Income inclusion*—(i) *Inclusion of all earnings and profits amount.* An exchanging shareholder shall include in income as a deemed dividend the all earnings and profits amount with respect to its stock in the foreign acquired corporation. For the consequences of the deemed dividend, see §1.367(b)–2(e). Notwithstanding §1.367(b)–2(e), however, a deemed dividend from the foreign acquired corporation to an exchanging foreign corporate shareholder shall not qualify for the exception from foreign personal holding company income provided by section 954(c)(3)(A)(i), although it may qualify for the look-through treatment provided by section 904(d)(3) if the requirements of that section are met with respect to the deemed dividend.

(ii) *Examples.* The following examples illustrate the rules of paragraph (b)(3)(i) of this section:

Example 1. (i) *Facts.* DC, a domestic corporation, owns all of the outstanding stock of FC, a foreign corporation. The stock of FC has a value of $100, and DC has a basis of $30 in such stock. The all earnings and profits amount attributable to the FC stock owned by DC is $20, of which $15 is described in section 1248(a) and the remaining $5 is not (for example, because it accumulated prior to 1963). FC has a basis of $50 in its assets. In a liquidation described in section 332, FC distributes all of its property to DC, and the FC stock held by DC is canceled.

(ii) *Result.* Under paragraph (b)(3)(i) of this section, DC must include $20 in income as a deemed dividend from FC. Under section 337(a) FC does not recognize gain or loss in the assets that it distributes to DC, and

under section 334(b), DC takes a basis of $50 in such assets. Because the requirements of section 902 are met, DC qualifies for a deemed paid foreign tax credit with respect to the deemed dividend that it receives from FC.

Example 2. (i) *Facts.* DC, a domestic corporation, owns all of the outstanding stock of FC, a foreign corporation. The stock of FC has a value of $100, and DC has a basis of $30 in such stock. The all earnings and profits amount attributable to the FC stock owned by DC is $75. FC has a basis of $50 in its assets. In a liquidation described in section 332, FC distributes all of its property to DC, and the FC stock held by DC is canceled.

(ii) *Result.* Under paragraph (b)(3)(i) of this section, DC must include $75 in income as a deemed dividend from FC. Under section 337(a) FC does not recognize gain or loss in the assets that it distributes to DC, and under section 334(b), DC takes a basis of $50 in such assets. Because the requirements of section 902 are met, DC qualifies for a deemed paid foreign tax credit with respect to the deemed dividend that it receives from FC.

Example 3. (i) *Facts.* DC, a domestic corporation, owns 80 percent of the outstanding stock of FC, a foreign corporation. DC has owned its 80 percent interest in FC since FC was incorporated. The remaining 20 percent of the outstanding stock of FC is owned by a person unrelated to DC (the minority shareholder). The stock of FC owned by DC has a value of $80, and DC has a basis of $24 in such stock. The stock of FC owned by the minority shareholder has a value of $20, and the minority shareholder has a basis of $18 in such stock. FC's only asset is land having a value of $100, and FC has a basis of $50 in the land. Gain on the land would not generate earnings and profits qualifying under section 1248(d) for an exclusion from earnings and profits for purposes of section 1248. FC has earnings and profits of $20 (determined under the rules of §1.367(b)–2(d)(2) (i) and (ii)), $16 of which is attributable to the stock owned by DC under the rules of §1.367(b)–2(d)(3). FC subdivides the land and distributes to the minority shareholder land with a value of $20 and a basis of $10. As part of the same transaction, in a liquidation described in section 332, FC distributes the remainder of its land to DC, and the FC stock held by DC and the minority shareholder is canceled.

(ii) *Result.* Under section 336, FC must recognize the $10 of gain it realizes in the land it distributes to the minority shareholder, and under section 331 the minority shareholder recognizes its gain of $2 in the stock of FC. Such gain is included in income by the minority shareholder as a dividend to the extent provided in section 1248 if the minority shareholder is a United States person that is described in section 1248(a)(2). Under §1.367(b)–2(d)(2)(iii), the $10 of gain recognized by FC increases its earnings and profits for purposes of computing the all earnings and profits amount and, as a result, $8 of such increase (80 percent of $10) is considered to be attributable to the FC stock owned by DC under §1.367(b)–2(d)(3)(i)(A)(*1*). DC's all earnings and profits amount with respect to its stock in FC is $24 (the $16 of initial all earnings and profits amount with respect to the FC stock held by DC, plus the $8 addition to such amount that results from FC's recognition of gain on the distribution to the minority shareholder). Under paragraph (b)(3)(i) of this section, DC must include the $24 all earnings and profits amount in income as a deemed dividend from FC.

Example 4. (i) *Facts.* DC1, a domestic corporation, owns all of the outstanding stock of DC2, a domestic corporation. DC1 also owns all of the outstanding stock of FC, a foreign corporation. The stock of FC has a value of $100, and DC1 has a basis of $30 in such stock. The assets of FC have a value of $100. The all earnings and profits amount with respect to the FC stock owned by DC1 is $20. In a reorganization described in section 368(a)(1)(D), DC2 acquires all of the assets of FC solely in exchange for DC2 stock. FC distributes the DC2 stock to DC1, and the FC stock held by DC1 is canceled.

(ii) *Result.* DC1 must include $20 in income as a deemed dividend from FC under paragraph (b)(3)(i) of this section. Under section 361, FC does not recognize gain or loss in the assets that it transfers to DC2 or in the DC2 stock that it distributes to DC1, and under section 362(b) DC2 takes a basis in the assets that it acquires from FC equal to the basis that FC had therein. Under §1.367(b)–2(e)(3)(ii) and section 358(a)(1), DC1 takes a basis of $50 (its $30 basis in the stock of FC, plus the $20 that was treated as a deemed dividend to DC1) in the stock of DC2 that it receives in exchange for the stock of FC. Under §1.367(b)–2(e)(3)(iii) and section 312(a), the earnings and profits of FC are reduced by the $20 deemed dividend.

Example 5. (i) *Facts.* DC1, a domestic corporation, owns all of the outstanding stock of FC1, a foreign corporation. FC1 owns all of the outstanding stock of FC2, a foreign corporation. The all earnings and profits amount with respect to the FC2 stock owned by FC1 is $20. In a reorganization described in section 368(a)(1)(A), DC2, a domestic corporation unrelated to FC1 or FC2, acquires all of the assets and liabilities of FC2 pursuant to a State W merger. FC2 receives DC2 stock and distributes such stock to FC1. The FC2 stock held by FC1 is canceled, and FC2 ceases its separate legal existence.

(ii) *Result.* FC1 must include $20 in income as a deemed dividend from FC2 under paragraph (b)(3)(i) of this section. The deemed dividend is treated as a dividend for purposes of the Internal Revenue Code as provided in §1.367(b)–2(e)(2); however, under paragraph

(b)(3)(i) of this section the deemed dividend cannot qualify for the exception from foreign personal holding company income provided by section 954(c)(3)(A)(i), even if the provisions of that section would otherwise have been met in the case of an actual dividend.

Example 6. (i) *Facts.* DC1, a domestic corporation, owns 99 percent of USP, a domestic partnership. The remaining 1 percent of USP is owned by a person unrelated to DC1. DC1 and USP each directly own 9 percent of the outstanding stock of FC, a foreign corporation that is not a controlled foreign corporation subject to the rule of section 953(c). In a reorganization described in section 368(a)(1)(C), DC2, a domestic corporation, acquires all of the assets and liabilities of FC in exchange for DC2 stock. FC distributes to its shareholders DC2 stock, and the FC stock held by its shareholders is canceled.

(ii) *Result.* (A) DC1 and USP are United States persons that are exchanging shareholders in a transaction described in paragraph (a) of this section. As a result, DC1 and USP are subject to the rules of paragraph (b) of this section if they qualify as United States shareholders as defined in paragraph (b)(2) of this section. Alternatively, if they do not qualify as United States shareholders as defined in paragraph (b)(2) of this section, DC1 and USP are subject to the rules of paragraph (c) of this section. Paragraph (b)(2) of this section defines the term United States shareholder to include any shareholder described in section 951(b) (without regard to whether the foreign corporation is a controlled foreign corporation). A shareholder described in section 951(b) is a United States person that is considered to own, applying the rules of section 958(a) and 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of a foreign corporation. Under section 958(b), the rules of section 318(a), as modified by section 958(b) and the regulations thereunder, apply so that, in general, stock owned directly or indirectly by a partnership is considered as owned proportionately by its partners, and stock owned directly or indirectly by a partner is considered as owned by the partnership. Thus, under section 958(b), DC1 is treated as owning its proportionate share of FC stock held by USP, and USP is treated as owning all of the FC stock held by DC1.

(B) Accordingly, for purposes of determining whether DC1 is a United States shareholder under paragraph (b)(2) of this section, DC1 is considered as owning 99 percent of the 9 percent of FC stock held by USP. Because DC1 also owns 9 percent of FC stock directly, DC1 is considered as owning more than 10 percent of FC stock. DC1 is thus a United States shareholder of FC under paragraph (b)(2) of this section and, as a result, is subject to the rules of paragraph (b) of this section. However, for purposes of determining DC1's all earnings and profits amount, DC1 is not treated as owning the FC stock held by USP. Under §1.367(b)–2(d)(3), DC1's all earnings and profits amount is determined by reference to the 9 percent of FC stock that it directly owns.

(C) For purposes of determining whether USP is a United States shareholder under paragraph (b)(2) of this section, USP is considered as owning the 9 percent of FC stock held by DC1. Because USP also owns 9 percent of FC stock directly, USP is considered as owning more than 10 percent of FC stock. USP is thus a United States shareholder of FC under paragraph (b)(2) of this section and, as a result, is subject to the rules of paragraph (b) of this section. However, for purposes of determining USP's all earnings and profits amount, USP is not treated as owning the FC shares held by DC1. Under §1.367(b)–2(d)(3), USP's all earnings and profits amount is determined by reference to the 9 percent of FC stock that it directly owns.

(iii) *Recognition of exchange gain or loss with respect to capital.* [Reserved]

(4) *Reserved.* For further guidance concerning section 367(b) exchanges occurring before February 23, 2001, see §1.367(b)–3T(b)(4).

(c) *Exchange of stock owned by a United States person that is not a United States shareholder*—(1) *Scope.* This paragraph (c) applies in the case of an exchanging shareholder that is a United States person not described in paragraph (b)(1)(i) of this section (*i.e.*, a United States person that is not a United States shareholder of the foreign acquired corporation).

(2) *Requirement to recognize gain.* An exchanging shareholder described in paragraph (c)(1) of this section shall recognize realized gain (but not loss) with respect to the stock of the foreign acquired corporation.

(3) *Election to include all earnings and profits amount.* In lieu of the treatment prescribed by paragraph (c)(2) of this section, an exchanging shareholder described in paragraph (c)(1) of this section may instead elect to include in income as a deemed dividend the all earnings and profits amount with respect to its stock in the foreign acquired corporation. For the consequences of a deemed dividend, see §1.367(b)–2(e). Such election may be made only if—

(i) The foreign acquired corporation (or its successor in interest) has provided the exchanging shareholder information to substantiate the exchanging shareholder's all earnings and profits amount with respect to its stock in the foreign acquired corporation; and

(ii) The exchanging shareholder complies with the section 367(b) notice requirement described in §1.367(b)–1(c), including the specific rules contained therein concerning the time and manner for electing to apply the rules of this paragraph (c)(3).

(4) *De minimis exception.* This paragraph (c) shall not apply in the case of an exchanging shareholder whose stock in the foreign acquired corporation has a fair market value of less than $50,000 on the date of the section 367(b) exchange.

(5) *Examples.* The following examples illustrate the rules of this paragraph (c):

Example 1. (i) *Facts.* DC1, a domestic corporation, owns 5 percent of the outstanding stock of FC, a foreign corporation that is not a controlled foreign corporation subject to the rule of section 953(c). Persons unrelated to DC1 own the remaining 95 percent of the outstanding stock of FC. DC1 has owned its 5 percent interest in FC since FC was incorporated. DC1's stock in FC has a basis of $40,000 and a value of $100,000. The all earnings and profits amount with respect to DC1's stock in FC is $50,000. In a reorganization described in section 368(a)(1)(C), DC2, a domestic corporation, acquires all of the assets and liabilities of FC in exchange for DC2 stock. FC distributes DC2 stock to its shareholders, and the FC stock held by its shareholders is canceled.

(ii) *Alternate result 1.* If DC1 does not make the election described in paragraph (c)(3) of this section, then the general rule of paragraph (c)(2) of this section applies and DC1 must recognize its $60,000 gain in the FC stock. Under section 358(a)(1), DC1 has a $100,000 basis (its $40,000 basis in the FC stock, plus the $60,000 recognized gain) in the DC2 stock that it receives in exchange for its FC stock. Because DC1 is not a shareholder described in section 1248(a)(2), section 1248 does not apply to recharacterize any of DC1's gain as a dividend.

(iii) *Alternate result 2.* If DC1 makes a valid election under paragraph (c)(3) of this section, then DC1 must include in income as a deemed dividend the $50,000 all earnings and profits amount with respect to its FC stock. Under §1.367(b)–2(e)(3) and section 358(a)(1), DC1 has a $90,000 basis (its $40,000 basis in the FC stock, plus the $50,000 that was treated as a deemed dividend to DC1) in the DC2 stock that it receives in exchange for its FC stock. Because DC1 owns less than 10 percent of the voting stock of FC, DC1 does not qualify for a deemed paid foreign tax credit under section 902.

Example 2. (i) *Facts.* The facts are the same as in *Example 1*, except that DC1's stock in FC has a fair market value of $48,000 on the date DC1 receives the DC2 stock.

(ii) *Result.* Because DC1's stock in FC has a fair market value of less than $50,000 on the date of the section 367(b) exchange, the de minimis exception of paragraph (c)(4) of this section applies. As a result, DC1 is not subject to the gain or income inclusion requirements of this paragraph (c).

(d) *Carryover of certain foreign taxes*—(1) *Rule.* Excess foreign taxes under section 904(c) allowable to the foreign acquired corporation under section 906 shall carry over to the domestic acquiring corporation and become allowable under section 901, subject to the limitations prescribed by the Internal Revenue Code (for example, sections 383, 904 and 907). The domestic acquiring corporation shall not succeed to any other foreign taxes paid or incurred by the foreign acquired corporation.

(2) *Example.* The following example illustrates the rules of this paragraph (d):

Example. (i) *Facts.* DC, a domestic corporation owns 100 percent of the outstanding stock of FC, a foreign corporation. FC has net positive earnings and profits, none of which are attributable to DC's FC stock under §1.367(b)–2(d)(3). FC has paid foreign taxes that are not eligible for credit under section 906. In a liquidation described in section 332, FC distributes all of its property to DC, and the FC stock held by DC is canceled.

(ii) *Result.* The liquidation of FC into DC is a section 367(b) exchange. Thus, DC is subject to the section 367(b) regulations, and must file a section 367(b) notice pursuant to §1.367(b)–1(c). Pursuant to the provisions of paragraph (d)(1) of this section, the foreign taxes paid by FC do not carryover to DC because FC's foreign taxes are not eligible for credit under section 906.

(e) *Net operating loss and capital loss carryovers.* A net operating loss or capital loss carryover of the foreign acquired corporation is described in section 381(c)(1) and (c)(3) and thus is eligible to carry over from the foreign acquired corporation to the domestic acquiring corporation only to the extent the underlying deductions or losses

were allowable under chapter 1 of subtitle A of the Internal Revenue Code. Thus, only a net operating loss or capital loss carryover that is effectively connected with the conduct of a trade or business within the United States (or that is attributable to a permanent establishment, in the context of an applicable United States income tax treaty) is eligible to be carried over under section 381. For further guidance, see Rev. Rul. 72–421 (1972–2 C.B. 166) (see also §601.601(d)(2) of this chapter).

(f) *Carryover of earnings and profits*—(1) General rule. Except to the extent otherwise specifically provided (see, e.g., Notice 89–79 (1989–2 C.B. 392) (see also §601.601(d)(2) of this chapter)), earnings and profits of the foreign acquired corporation that are not included in income as a deemed dividend under the section 367(b) regulations (or deficit in earnings and profits) are eligible to carry over from the foreign acquired corporation to the domestic acquiring corporation under section 381(c)(2) only to the extent such earnings and profits (or deficit in earnings and profits) are effectively connected with the conduct of a trade or business within the United States (or are attributable to a permanent establishment in the United States, in the context of an applicable United States income tax treaty). All other earnings and profits (or deficit in earnings and profits) of the foreign acquired corporation shall not carry over to the domestic acquiring corporation and, as a result, shall be eliminated.

(2) *Previously taxed earnings and profits.* [Reserved]

[T.D. 8862, 65 FR 3601, Jan. 24, 2000; 65 FR 66501, Nov. 6, 2000, as amended by T.D. 9243, 71 FR 4288, Jan. 26, 2006; T.D. 9273, 71 FR 44895, Aug. 8, 2006]

§ 1.367(b)–3T Repatriation of foreign corporate assets in certain nonrecognition transactions (temporary).

(a)–(b)(3) [Reserved]. For further guidance, see §1.367(b)–3(a) through (b)(3).

(4) *Election of taxable exchange treatment*—(i) *Rules*—(A) *In general.* In lieu of the treatment prescribed by §1.367(b)–3(b)(3)(i), an exchanging shareholder described in §1.367(b)–3(b)(1) may instead elect to recognize the gain (but not loss) that it realizes in the exchange (taxable exchange election). To make a taxable exchange election, the following requirements must be satisfied—

(*1*) The exchanging shareholder (and its direct or indirect owners that would be affected by the election, in the case of an exchanging shareholder that is a foreign corporation) reports the exchange in a manner consistent therewith (see, e.g., sections 954(c)(1)(B)(i), 1001 and 1248);

(*2*) The notification requirements of paragraph (b)(4)(i)(C) of this section are satisfied; and

(*3*) The adjustments described in paragraph (b)(4)(i)(B) of this section are made when the following circumstances are present—

(*i*) The transaction is described in section 332 or is an asset acquisition described in section 368(a)(1), with regard to which one U.S. person owns (directly or indirectly) 100 percent of the foreign acquired corporation; and

(*ii*) The all earnings and profits amount described in §1.367(b)–3(b)(3)(i) with respect to the exchange exceeds the gain recognized by the exchanging shareholder.

(B) *Attribute reduction—*(*1*) *Reduction of NOL carryovers.* The amount by which the all earnings and profits amount exceeds the gain recognized by the exchanging shareholder (the excess earnings and profits amount) shall be applied to reduce the net operating loss carryovers (if any) of the foreign acquired corporation to which the domestic acquiring corporation would otherwise succeed under section 381(a) and (c)(1). See also Rev. Rul. 72–421 (1972–2 C.B. 166) (see §601.601(d)(2) of this chapter).

(*2*) *Reduction of capital loss carryovers.* After the application of paragraph (b)(4)(i)(B)(*1*) of this section, any remaining excess earnings and profits amount shall be applied to reduce the capital loss carryovers (if any) of the foreign acquired corporation to which the domestic acquiring corporation would otherwise succeed under section 381(a) and (c)(3).

(*3*) *Reduction of basis.* After the application of paragraph (b)(4)(i)(B)(*2*) of this section, any remaining excess

earnings and profits amount shall be applied to reduce (but not below zero) the basis of the assets (other than dollar-denominated money) of the foreign acquired corporation that are acquired by the domestic acquiring corporation. Such remaining excess earnings and profits amount shall be applied to reduce the basis of such assets in the following order: first, tangible depreciable or depletable assets, according to their class lives (beginning with those assets with the shortest class life); second, other non-inventory tangible assets; third, intangible assets that are amortizable; and finally, the remaining assets of the foreign acquired corporation that are acquired by the domestic acquiring corporation. Within each of these categories, if the total basis of all assets in the category is greater than the excess earnings and profits amount to be applied against such basis, the taxpayer may choose to which specific assets in the category the basis reduction first applies.

(C) *Notification.* The exchanging shareholder shall elect to apply the rules of this paragraph (b)(4)(i) by attaching a statement of its election to its section 367(b) notice. See §1.367(b)–1(c) For the rules concerning filing a section 367(b) notice.

(D) *Example.* The following example illustrates the rules of this paragraph (b)(4)(i):

Example. (i) *Facts.* DC, a domestic corporation, owns all of the outstanding stock of FC, a foreign corporation. The stock of FC has a value of $100, and DC has a basis of $80 in such stock. The assets of FC are one parcel of land with a value of $60 and a basis of $30, and tangible depreciable assets with a value of $40 and a basis of $80. FC has no net operating loss carryovers or capital loss carryovers. The all earnings and profits amount with respect to the FC stock owned by DC is $30, of which $19 is described in section 1248(a) and the remaining $11 is not (for example, because it was earned prior to 1963). In a liquidation described in section 332, FC distributes all of its property to DC, and the FC stock held by DC is canceled. Rather than including in income as a deemed dividend the all earnings and profits amount of $30 as provided in §1.367(b)–3(b)(3)(i), DC instead elects taxable exchange treatment under paragraph (b)(4)(i)(A) of this section.

(ii) *Result.* DC recognizes the $20 of gain it realizes on its stock in FC. Of this $20 amount, $19 is included in income by DC as a dividend pursuant to section 1248(a). (For the source of the remaining $1 of gain recognized by DC, see section 865. For the treatment of the $1 for purposes of the foreign tax credit limitation, see generally section 904(d)(2)(A)(i).) Because the transaction is described in section 332 and because the all earnings and profits amount with respect to the FC stock held by DC ($30) exceeds by $10 the income recognized by DC ($20), the attribute reduction rules of paragraph (b)(4)(i)(B) of this section apply. Accordingly, the $10 excess earnings and profits amount is applied to reduce the basis of the tangible depreciable assets of FC, beginning with those assets with the shortest class lives. Under section 337(a) FC does not recognize gain or loss in the assets that it distributes to DC, and under section 334(b) (which is applied taking into account the basis reduction prescribed by paragraph (b)(4)(i)(A)(*3*) of this section) DC takes a basis of $30 in the land and $70 in the tangible depreciable assets that it receives from FC.

(ii) *Effective date.* This paragraph (b)(4) applies for section 367(b) exchanges that occur between February 23, 2000, and February 23, 2001.

(c)–(d) [Reserved]. For further guidance, see §1.367(b)–3(c) through (d).

[T.D. 8863, 65 FR 3588, Jan. 24, 2000, as amended by T.D. 9243, 71 FR 4288, Jan. 26, 2006]

§1.367(b)–4 Acquisition of foreign corporate stock or assets by a foreign corporation in certain nonrecognition transactions.

(a) *Scope.* This section applies to an acquisition by a foreign corporation (the foreign acquiring corporation) of the stock of a foreign corporation in an exchange described in section 351 or of the stock or assets of a foreign corporation in a reorganization described in section 368(a)(1) (in either case, the foreign acquired corporation). For rules applicable when, pursuant to section 304(a)(1), a foreign acquiring corporation is treated as acquiring the stock of a foreign acquired corporation in a transaction to which section 351(a) applies, see §1.367(b)–4T(e). For purposes of this section, the term *triangular reorganization* means a reorganization described in §1.358–6(b)(2)(i) through (b)(2)(v) (forward triangular merger, triangular C reorganization, reverse triangular merger, triangular B reorganization, and triangular G reorganization, respectively). In the case of a triangular reorganization other than

a reverse triangular merger, the surviving corporation is the foreign acquiring corporation that acquires the assets or stock of the foreign acquired corporation, and the reference to controlling corporation (foreign or domestic) is to the corporation that controls the surviving corporation. In the case of a reverse triangular merger, the surviving corporation is the entity that survives the merger, and the controlling corporation (foreign or domestic) is the corporation that before the merger controls the merged corporation. In the case of a reverse triangular merger, this section applies if stock of the foreign surviving corporation is exchanged for stock of a foreign corporation in control of the merging corporation; in such a case, the foreign surviving corporation is treated as a foreign acquired corporation for purposes of this section. A foreign corporation that undergoes a reorganization described in section 368(a)(1)(E) is treated as both the foreign acquired corporation and the foreign acquiring corporation for purposes of this section. See §1.367(a)–3(b)(2) for transactions subject to the concurrent application of sections 367(a) and (b).

(b) *Income inclusion.* If an exchange is described in paragraph (b)(1)(i), (2)(i) or (3) of this section, the exchanging shareholder shall include in income as a deemed dividend the section 1248 amount attributable to the stock that it exchanges.

(1) *Exchange that results in loss of status as section 1248 shareholder*—(i) *General rule.* Except as provided in paragraph (b)(1)(ii) of this section, an exchange is described in this paragraph (b)(1)(i) if—

(A) Immediately before the exchange, the exchanging shareholder is—

(*1*) A United States person that is a section 1248 shareholder with respect to the foreign acquired corporation; or

(*2*) A foreign corporation, and a United States person is a section 1248 shareholder with respect to such foreign corporation and with respect to the foreign acquired corporation; and

(B) Either of the following conditions is satisfied—

(*1*) Immediately after the exchange, the stock received in the exchange is not stock in a corporation that is a controlled foreign corporation as to which the United States person described in paragraph (b)(1)(i)(A) of this section is a section 1248 shareholder; or

(*2*) Immediately after the exchange, the foreign acquiring corporation or the foreign acquired corporation (in the case of the acquisition of the stock of a foreign acquired corporation) is not a controlled foreign corporation as to which the United States person described in paragraph (b)(1)(i)(A) of this section is a section 1248 shareholder.

(ii) *Special rules*—(A) *Receipt of foreign stock in an exchange to which §1.367(a)–7(c) applies.* If an exchanging shareholder is a domestic corporation that transfers stock of a foreign acquired corporation in an exchange under section 361(a) or (b) (section 361 exchange) to which the exception to section 367(a)(5) in §1.367(a)–7(c) applies, and the exchanging shareholder receives stock in either the foreign acquiring corporation or foreign controlling corporation (in the case of a triangular reorganization), such exchange will not be described in paragraph (b)(1)(i) of this section only if immediately after the exchanging shareholder's receipt of the foreign stock in the section 361 exchange, but prior to, and without taking into account, the exchanging shareholder's distribution of the foreign stock under section 361(c)(1), the foreign acquired corporation, foreign acquiring corporation, and foreign controlling corporation (in the case of a triangular reorganization) are controlled foreign corporations as to which the exchanging shareholder is a section 1248 shareholder. See paragraph (b)(1)(iii) of this section, *Example 4*, for an illustration of this rule. If an exchange is not described in paragraph (b)(1)(i) of this section as a result of the application of this paragraph, see §§1.1248(f)–1(b)(3) and 1.1248(f)–2(c), as applicable. For adjustments to the basis of stock of the foreign surviving corporation in certain triangular reorganizations, see paragraph (b)(1)(ii)(B)(*2*)(*i*) of this section.

(B) *Special rules for certain triangular reorganizations*—(*1*) *Receipt of domestic stock.* In the case of a triangular reorganization in which the stock received in the exchange is stock of a domestic controlling corporation, such exchange

is not described in paragraph (b)(1)(i) of this section if immediately after the exchange the following foreign corporations are controlled foreign corporations as to which the domestic controlling corporation is a section 1248 shareholder—

(*i*) The foreign acquired corporation and foreign surviving corporation, in the case of a section 354 exchange of the stock of the foreign acquired corporation pursuant to a triangular B reorganization.

(*ii*) The foreign surviving corporation, in the case of a section 354 or section 356 exchange of the stock of the foreign acquired corporation pursuant to a forward triangular merger, triangular C reorganization, reverse triangular merger, or triangular G reorganization. See paragraph (b)(1)(iii) of this section, *Example 3B* for an illustration of this rule.

(*iii*) The foreign acquired corporation and foreign surviving corporation, in the case of a section 361 exchange of the stock of the foreign acquired corporation by an exchanging shareholder that is a foreign corporation described in paragraph (b)(1)(i)(A)(*2*) of this section and that is a foreign acquired corporation the assets of which are acquired in a triangular reorganization described in paragraph (b)(1)(ii)(B)(*1*)(*ii*) of this section.

(*iv*) The foreign acquired corporation and foreign surviving corporation, in the case of a section 361 exchange of the stock of the foreign acquired corporation by an exchanging shareholder that is a domestic corporation described in paragraph (b)(1)(i)(A)(*1*) of this section and that is acquired in a triangular reorganization to which the exception to section 367(a)(5) in §1.367(a)–7(c) applies. See paragraph (b)(1)(iii) of this section, *Example 5* for an illustration of this rule.

(*2*) *Adjustments to basis of stock of foreign surviving corporation—*(*i*) *Section 361 exchanges to which §1.367(a)–7(c) applies.* If stock of the foreign acquired corporation is acquired by the foreign surviving corporation in a section 361 exchange by reason of triangular reorganization (other than a triangular B reorganization) to which the exception to section 367(a)(5) provided in §1.367(a)–7(c) applies, and if paragraph (b)(1)(i) of this section does not apply to the section 361 exchange by reason of (b)(1)(ii)(A) of this section (if the stock received is stock of a foreign controlling corporation) or by reason of (b)(1)(ii)(B)(*1*)(*iv*) of this section (if the stock received is stock of a domestic controlling corporation), then the controlling corporation (foreign or domestic) must apply the principles of §1.367(b)–13 to adjust the basis of the stock of the foreign surviving corporation so that the section 1248 amount in the stock of the foreign acquired corporation (determined when the foreign surviving corporation acquires such stock) is reflected in the stock of the foreign surviving corporation immediately after the exchange. See paragraph (b)(1)(iii) of this section, *Example 5*, for an illustration of this rule.

(*ii*) *Other exchanges.* See §1.367(b)–13 for rules regarding the adjustment to the basis of the stock of the foreign surviving corporation in exchanges pursuant to triangular reorganizations that are not subject to paragraph (b)(1)(ii)(B)(*2*)(*i*) of this section.

(iii) *Examples.* The following examples illustrate the rules of this paragraph (b)(1):

Example 1. (i) *Facts.* FC1 is a foreign corporation that is owned, directly and indirectly (applying the ownership rules of section 958), solely by foreign persons. DC is a domestic corporation that is unrelated to FC1. DC owns all of the outstanding stock of FC2, a foreign corporation. Thus, under §1.367(b)–2(a) and (b), DC is a section 1248 shareholder with respect to FC2, and FC2 is a controlled foreign corporation. Under §1.367(b)–2(c)(1), the section 1248 amount attributable to the stock of FC2 held by DC is $20. In a reorganization described in section 368(a)(1)(C), FC1 acquires all of the assets and assumes all of the liabilities of FC2 in exchange for FC1 voting stock. The FC1 voting stock received does not represent more than 50 percent of the voting power or value of FC1's stock. FC2 distributes the FC1 stock to DC, and the FC2 stock held by DC is canceled.

(ii) *Result.* FC1 is not a controlled foreign corporation immediately after the exchange. As a result, the exchange is described in paragraph (b)(1)(i) of this section. Under paragraph (b) of this section, DC must include in income, as a deemed dividend from FC2, the section 1248 amount ($20) attributable to the FC2 stock that DC exchanged.

Example 2. (i) *Facts.* The facts are the same as in *Example 1*, except that the voting stock

of FC1, which is received by FC2 in exchange for its assets and distributed by FC2 to DC, represents more than 50 percent of the voting power of FC1's stock under the rules of section 957(a).

(ii) *Result.* Paragraph (b)(1)(i) of this section does not apply to require inclusion in income of the section 1248 amount, because FC1 is a controlled foreign corporation as to which DC is a section 1248 shareholder immediately after the exchange.

Example 3. (i) *Facts.* The facts are the same as in *Example 1,* except that FC2 receives and distributes voting stock of FP, a foreign corporation that is in control (within the meaning of section 368(c)) of FC1, instead of receiving and distributing voting stock of FC1.

(ii) *Result.* For purposes of section 367(a), the transfer is an indirect stock transfer subject to section 367(a). See §1.367(a)–3(d)(1)(iv). Accordingly, DC's exchange of FC2 stock for FP stock under section 354 will be taxable under section 367(a) (and section 1248 will be applicable) if DC fails to enter into a gain recognition agreement in accordance with §1.367(a)–8. Under §1.367(a)–3(b)(2), if DC enters into a gain recognition agreement, the exchange will be subject to the provisions of section 367(b) and the regulations thereunder, as well as section 367(a). If FP and FC1 are controlled foreign corporations as to which DC is a (direct or indirect) section 1248 shareholder immediately after the reorganization, then the section 367(b) result is the same as in *Example 2*—that is, paragraph (b)(1)(i) of this section does not apply to require inclusion in income of the section 1248 amount. Under these circumstances, the amount of the gain recognition agreement would equal the amount of the gain realized on the indirect stock transfer. If FP or FC1 is not a controlled foreign corporation as to which DC is a (direct or indirect) section 1248 shareholder immediately after the exchange, then the section 367(b) result is the same as in *Example 1*—that is, DC must include in income, as a deemed dividend from FC2, the section 1248 amount ($20) attributable to the FC2 stock that DC exchanged. Under these circumstances, the amount of the gain recognition agreement would equal the amount of the gain realized on the indirect stock transfer, less the $20 section 1248 amount inclusion.

Example 3A. (i) *Facts.* The facts are the same as in *Example 3,* except that FC1 merges into FC2 in a reorganization described in sections 368(a)(1)(A) and (a)(2)(E). Pursuant to the reorganization, DC exchanges its FC2 stock for stock of FP.

(ii) *Result.* The result is similar to the result in *Example 3.* The transfer is an indirect stock transfer subject to section 367(a). See §1.367(a)–3(d)(1)(ii). Accordingly, DC's exchange of FC2 stock for FP stock will be taxable under section 367(a) (and section 1248 will be applicable) if DC fails to enter into a gain recognition agreement. If DC enters into a gain recognition agreement, the exchange will be subject to the provisions of section 367(b) and the regulations thereunder, as well as section 367(a). If FP and FC2 are controlled foreign corporations as to which DC is a section 1248 shareholder immediately after the reorganization, then paragraph (b)(1)(i) of this section does not apply to require DC to include in income the section 1248 amount attributable to the FC2 stock that was exchanged and the amount of the gain recognition agreement is the amount of gain realized on the indirect stock transfer. If FP or FC2 is not a controlled foreign corporation as to which DC is a section 1248 shareholder immediately after the exchange, then DC must include in income as a deemed dividend from FC2 the section 1248 amount ($20) attributable to the FC2 stock that DC exchanged. Under these circumstances, the gain recognition agreement would be the amount of gain realized on the indirect transfer, less the $20 section 1248 amount inclusion.

Example 3B. (i) *Facts.* The facts are the same as *Example 3,* except that USP, a domestic corporation, owns the controlling interest (within the meaning of section 368(c)) in FC1 stock. In addition, FC2 merges into FC1 in a reorganization described in sections 368(a)(1)(A) and (a)(2)(D). Pursuant to the reorganization, DC exchanges its FC2 stock for USP stock.

(ii) *Result.* Because DC receives stock of a domestic corporation, USP, in the section 354 exchange, the transfer is not an indirect stock transfer subject to section 367(a). Accordingly, the exchange will be subject only to the provisions of section 367(b) and the regulations thereunder. Under paragraph (b)(1)(ii) of this section, because the stock received is stock of a domestic corporation (USP) and, immediately after the exchange, USP is a section 1248 shareholder of FC1 (the surviving corporation) and FC1 is a controlled foreign corporation, the exchange is not described in paragraph (b)(1)(i) of this section and DC is not required to include in income the section 1248 amount attributable to the FC2 stock that was exchanged. See §1.367(b)–13(c) for the basis and holding period rules applicable to this transaction, which cause USP's adjusted basis and holding period in the stock of FC1 after the transaction to reflect the basis and holding period that DC had in its FC2 stock.

Example 4. (i) *Facts.* DC1, a domestic corporation, owns all of the outstanding stock of DC2, a domestic corporation. DC2 owns various assets, including all of the outstanding stock of FC2, a foreign corporation. The stock of FC2 has a value of $100, and DC2 has a basis of $30 in the stock. The section 1248 earnings and profits attributable to the FC2 stock held by DC2 is $20. DC2 does not own any stock other than the FC2 stock. FC1

is a foreign corporation that is unrelated to DC1, DC2, and FC2. In a reorganization described in section 368(a)(1)(C), FC1 acquires all of the assets of DC2 in exchange for the assumption of DC2's liabilities and voting stock of FC1 that represents 20% of the outstanding voting stock of FC1. DC2 distributes the FC1 stock to DC1 under section 361(c)(1), and the DC2 stock held by DC1 is canceled. The exception to section 367(a)(5) provided in §1.367(a)–7(c) applies to the section 361 exchange. DC1 properly files a gain recognition agreement that satisfies the conditions of §§1.367(a)–3(e)(6) and 1.367(a)–8 to qualify for nonrecognition treatment under section 367(a) with respect to DC2's transfer of the FC2 stock to FC1. See §1.367(a)–3(e). FC1 is not a surrogate foreign corporation (within the meaning of section 7874) because DC1 does not hold at least 60% of the stock of FC1 by reason of holding stock of DC2.

(ii) *Result.* DC2, the exchanging shareholder, is a U.S. person and a section 1248 shareholder with respect to FC2, the foreign acquired corporation. Whether DC2 is required to include in income the section 1248 amount attributable to the FC2 stock under paragraph (b)(1)(i) of this section depends on whether, immediately after DC2's section 361 exchange of the FC2 stock for FC1 stock (and before the distribution of the FC1 stock to DC1 under section 361(c)(1)), FC1 and FC2 are controlled foreign corporations as to which DC2 is a section 1248 shareholder. See paragraph (b)(1)(ii)(A) of this section. If, immediately after the section 361 exchange (and before the distribution of the FC1 stock to DC1 under section 361(c)(1)), FC1 and FC2 are both controlled foreign corporations as to which DC2 is a section 1248 shareholder, then DC2 is not required to include in income the section 1248 amount attributable to the FC2 stock under paragraph (b)(1)(i) of this section because neither condition in paragraph (b)(1)(i)(B) of this section is satisfied. Alternatively, if immediately after the section 361 exchange (and before the distribution of the FC1 stock to DC1 under section 361(c)(1)) either FC1 or FC2 is not a controlled foreign corporation as to which DC2 is a section 1248 shareholder, then, pursuant to paragraph (b)(1)(i) of this section, DC2 must include in income the section 1248 amount attributable to the FC2 stock. For the treatment of DC2's transfer of assets other than the FC2 stock to FC1, see section 367(a)(1) and (a)(3) and the regulations under that section. Furthermore, because DC2's transfer of any other assets to FC1 is pursuant to a section 361 exchange, see section 367(a)(5) and §1.367(a)–7. If any of the assets transferred are intangible assets for purposes of section 367(d), see section 367(d). With respect to DC2's distribution of the FC1 stock to DC1 under section 361(c)(1), see section 1248(f)(1), and §§1.1248(f)–1 and 1.1248(f)–2.

Example 5. (i) *Facts.* DC1, a domestic corporation, wholly owns DC2, a domestic corporation. The DC2 stock has a $100x fair market value, and DC1 has a basis of $30x in the stock. DC2's only asset is all of the outstanding stock of FC2, a foreign corporation. The FC2 stock has a $100x fair market value, and DC2 has a basis of $30x in the stock. There are $20x of earnings and profits attributable to the FC2 stock for purposes of section 1248. USP, a domestic corporation unrelated to DC1, DC2, and FC2, wholly owns FC1, a foreign corporation. In a triangular reorganization described in section 368(a)(1)(C), DC2 transfers all the FC2 stock to FC1 in exchange solely for voting stock of USP, and distributes the USP stock to DC1 under section 361(c)(1). DC1 exchanges its DC2 stock for the USP stock under section 354. DC2's transfer of the FC2 stock to FC1 is described in section 361(a) and therefore, under section 367(a)(5) and §1.367(a)–7, is generally subject to section 367(a)(1). However, the exception to section 367(a)(5) provided in §1.367(a)–7(c) applies to the section 361 exchange. In addition, DC1 is not required to adjust the basis of its USP stock (determined under section 358) under section 367(a)(5) and §1.367(a)–7(c)(3). DC1 properly files a gain recognition agreement that satisfies the conditions of §§1.367(a)–3(e)(6) and 1.367(a)–8 to qualify for nonrecognition treatment under section 367(a) with respect to DC2's transfer of the FC2 stock to FC1. See §1.367(a)–3(e).

(ii) *Result.* Immediately after the exchange, FC1 and FC2 are controlled foreign corporations as to which USP is a section 1248 shareholder because USP directly and indirectly owns all the FC1 stock and FC2 stock, respectively. Because DC2 receives stock of a domestic corporation (USP) in exchange for the FC2 stock and, immediately after the exchange, FC1 and FC2 are controlled foreign corporations as to which USP is a section 1248 shareholder, DC2's exchange of the FC2 stock for the USP stock is not described in paragraph (b)(1)(i) of this section. See paragraph (b)(1)(ii)(B)(*1*)(*iv*) of this section. Therefore, DC2 is not required to include in income the section 1248 amount in the FC2 stock. Under paragraph (b)(1)(ii)(B)(*2*)(*i*) of this section, USP must apply the principles of §1.367(b)–13 to adjust the basis of its FC1 stock to preserve the section 1248 amount ($20x) in the FC2 stock. Under the principles of §1.367(b)–13, each share of FC1 stock held by USP after the exchange must be divided into portions, one portion attributable to the FC1 stock owned before the exchange and one portion attributable to the FC2 stock received in the exchange. The $30x basis in the FC2 stock and the $20x earnings and profits attributable to the FC2 stock before the exchange are attributable to the divided portions of the FC1 stock to which the FC2 stock relates.

(2) *Receipt by exchanging shareholder of preferred or other stock in certain instances*—(i) *Rule.* An exchange is described in this paragraph (b)(2)(i) if—

(A) Immediately before the exchange, the foreign acquired corporation and the foreign acquiring corporations are not members of the same affiliated group (within the meaning of section 1504(a), but without regard to the exceptions set forth in section 1504(b), and substituting the words ''more than 50'' in place of the words ''at least 80'' in sections 1504(a)(2)(A) and (B));

(B) Immediately after the exchange, a domestic corporation meets the ownership threshold specified by section 902(a) or (b) such that it may qualify for a deemed paid foreign tax credit if it receives a distribution from the foreign acquiring corporation (directly or through tiers); and

(C) The exchanging shareholder receives preferred stock (other than preferred stock that is fully participating with respect to dividends, redemptions and corporate growth) in consideration for common stock or preferred stock that is fully participating with respect to dividends, redemptions and corporate growth, or, in the discretion of the Commissioner or the Commissioner's delegate (and without regard to whether the stock exchanged is common stock or preferred stock), receives stock that entitles it to participate (through dividends, redemption payments or otherwise) disproportionately in the earnings generated by particular assets of the foreign acquired corporation or foreign acquiring corporation.

(ii) *Examples.* The following examples illustrate the rules of this paragraph (b)(2):

Example 1. (i) *Facts.* FC1 is a foreign corporation. DC is a domestic corporation that is unrelated to FC1. DC owns all of the outstanding stock of FC2, a foreign corporation, and FC2 has no outstanding preferred stock. The value of FC2 is $100 and DC has a basis of $50 in the stock of FC2. Under §1.367(b)–2(c)(1), the section 1248 amount attributable to the stock of FC2 held by DC is $20. In a reorganization described in section 368(a)(1)(B), FC1 acquires all of the stock of FC2 and, in exchange, DC receives FC1 voting preferred stock that constitutes 10 percent of the voting stock of FC1 for purposes of section 902(a). Immediately after the exchange, FC1 and FC2 are controlled foreign corporations and DC is a section 1248 shareholder of FC1 and FC2, so paragraph (b)(1)(i) of this section does not require inclusion in income of the section 1248 amount.

(ii) *Result.* Pursuant to §1.367(a)–3(b)(2), the transfer is subject to both section 367(a) and section 367(b). Under §1.367(a)–3(b)(1), DC will not be subject to tax under section 367(a)(1) if it enters into a gain recognition agreement in accordance with §1.367(a)–8. Even though paragraph (b)(1)(i) of this section does not apply to require inclusion in income by DC of the section 1248 amount, DC must nevertheless include the $20 section 1248 amount in income as a deemed dividend from FC2 under paragraph (b)(2)(i) of this section. Thus, if DC enters into a gain recognition agreement, the amount is $30 (the $50 gain realized less the $20 recognized under section 367(b)). If DC fails to enter into a gain recognition agreement, it must include in income under section 367(a)(1) the $50 of gain realized ($20 of which is treated as a dividend under section 1248). Section 367(b) does not apply in such case.

Example 2. (i) *Facts.* The facts are the same as in *Example 1,* except that DC owns all of the outstanding stock of FC1 immediately before the transaction.

(ii) *Result.* Both section 367(a) and section 367(b) apply to the transfer. Paragraph (b)(2)(i) of this section does not apply to require inclusion of the section 1248 amount. Under paragraph (b)(2)(i)(A) of this section, the transaction is outside the scope of paragraph (b)(2)(i) of this section because FC1 and FC2 are, immediately before the transaction, members of the same affiliated group (within the meaning of such paragraph). Thus, if DC enters into a gain recognition agreement in accordance with §1.367(a)–8, the amount of such agreement is $50. As in *Example 1,* if DC fails to enter into a gain recognition agreement, it must include in income $50, $20 of which will be treated as a dividend under section 1248.

Example 3. (i) *Facts.* FC1 is a foreign corporation. DC is a domestic corporation that is unrelated to FC1. DC owns all of the outstanding stock of FC2, a foreign corporation. The section 1248 amount attributable to the stock of FC2 held by DC is $20. In a reorganization described in section 368(a)(1)(B), FC1 acquires all of the stock of FC2 in exchange for FC1 voting stock that constitutes 10 percent of the voting stock of FC1 for purposes of section 902(a). The FC1 voting stock received by DC in the exchange carries voting rights in FC1, but by agreement of the parties the shares entitle the holder to dividends, amounts to be paid on redemption, and amounts to be paid on liquidation, that are to be determined by reference to the earnings or value of FC2 as of the date of such event, and that are affected by the earnings or value of FC1 only if FC1 becomes insolvent or has insufficient capital surplus to pay dividends.

(ii) *Result.* Under §1.367(a)–3(b)(1), DC will not be subject to tax under section 367(a)(1) if it enters into a gain recognition agreement with respect to the transfer of FC2 stock to FC1. Under §1.367(a)–3(b)(2), the exchange will be subject to the provisions of section 367(b) and the regulations thereunder to the extent that it is not subject to tax under section 367(a)(1). Furthermore, even if DC would not otherwise be required to recognize income under this section, the Commissioner or the Commissioner's delegate may nevertheless require that DC include the $20 section 1248 amount in income as a deemed dividend from FC2 under paragraph (b)(2)(i) of this section.

(3) *Certain recapitalizations.* An exchange pursuant to a recapitalization under section 368(a)(1)(E) shall be deemed to be an exchange described in this paragraph (b)(3) if the following conditions are satisfied—

(i) During the 24-month period immediately preceding or following the date of the recapitalization, the corporation that undergoes the recapitalization (or a predecessor of, or successor to, such corporation) also engages in a transaction that would be described in paragraph (b)(2)(i) of this section but for paragraph (b)(2)(i)(C) of this section, either as the foreign acquired corporation or the foreign acquiring corporation; and

(ii) The exchange in the recapitalization is described in paragraph (b)(2)(i)(C) of this section.

(c) *Exclusion of deemed dividend from foreign personal holding company income*—(1) *Rule.* In the event the section 1248 amount is included in income as a deemed dividend by a foreign corporation under paragraph (b) of this section, such deemed dividend shall not be included as foreign personal holding company income under section 954(c).

(2) *Example.* The following example illustrates the rule of this paragraph (c):

Example. (i) *Facts.* FC1 is a foreign corporation that is owned, directly and indirectly (applying the ownership rules of section 958), solely by foreign persons. DC is a domestic corporation that is unrelated to FC1. DC owns all of the outstanding stock of FC2, a foreign corporation. FC2 owns all of the outstanding stock of FC3, a foreign corporation. Under §1.367(b)–2(c)(1), the section 1248 amount attributable to the stock of FC3 held by FC2 is $20. In a reorganization described in section 368(a)(1)(B), FC1 acquires from FC2 all of the stock of FC3 in exchange for FC1 voting stock. The FC1 voting stock received by FC2 does not represent more than 50 percent of the voting power or value of FC1's stock.

(ii) *Result.* FC1 is not a controlled foreign corporation immediately after the exchange. Under paragraph (b)(1) of this section, FC2 must include in income, as a deemed dividend from FC3, the section 1248 amount ($20) attributable to the FC3 stock that FC2 exchanged. The deemed dividend is treated as a dividend for purposes of the Internal Revenue Code as provided in §1.367(b)–2(e)(2); however, under this paragraph (c) the deemed dividend is not foreign personal holding company income to FC2.

(d) *Rules for subsequent sales or exchanges*—(1) *Rule.* If an exchanging shareholder (as defined in §1.1248–8(b)(1)(iv)) is not required to include in income as a deemed dividend the section 1248 amount under paragraph (b) of this section in a section 367(b) exchange described in paragraph (a) of this section (non-inclusion exchange), then, for purposes of applying section 367(b) or section 1248 to subsequent sales or exchanges, and subject to the limitation of §1.367(b)–2(d)(3)(ii) (in the case of a transaction described in §1.367(b)–3), the determination of the earnings and profits attributable to the stock an exchanging shareholder receives in the non-inclusion exchange shall be determined pursuant to the rules of section 1248 and the regulations under that section.

(2) *Example.* The following example illustrates the rules of this section. For purposes of the example, assume that—

(i) There is no immediate gain recognition pursuant to section 367(a)(1) and the regulations under that section (either through operation of the rules or because the appropriate parties have entered into a gain recognition agreement under §§1.367(a)–3(b) and 1.367(a)–8);

(ii) References to earnings and profits are to earnings and profits that would be includible in income as a dividend under section 1248 and the regulations under that section if stock to which the earnings and profits are attributable were sold or exchanged by its shareholder;

(iii) Each corporation has only a single class of stock outstanding and uses the calendar year as its taxable year; and

(iv) Each transaction is unrelated to all other transactions.

Example. Acquisition of the stock of a foreign corporation that controls a foreign acquiring corporation in a reorganization described in section 368(a)(1)(C). (i) *Facts.* DC1, a domestic corporation, has owned all the stock of CFC1, a controlled foreign corporation, since its formation on January 1, year 1. CFC1 has owned all the stock of CFC2, a controlled foreign corporation, since its formation on January 1, year 1. FC, a foreign corporation that is not a controlled foreign corporation, has owned all of the stock of FC2, a foreign corporation, since its formation on January 1, year 2. On December 31, year 3, pursuant to a restructuring transaction that was a triangular reorganization described in section 368(a)(1)(C), CFC1 transfers all of its assets, including the CFC2 stock, to FC2 in exchange for 80% of the voting stock of FC. CFC1 transfers the voting stock of FC to DC1 and the CFC1 stock is cancelled. Pursuant to section 1223(1), DC1 is considered to have held the stock of FC since January 1, year 1. Under section 1223(2), FC2 is considered to have held the stock of CFC2 since January 1, year 1. On December 31, year 3, CFC1 has $100 of earnings and profits. From January 1, year 4, until December 31, year 5, FC (a controlled foreign corporation after the restructuring transaction) accumulates an additional $50 of earnings and profits. FC2, a controlled foreign corporation after the restructuring transaction, accumulates $100 of earnings and profits from January 1, year 4, until December 31, year 5. On December 31, year 5, FC is liquidated into DC1 in a transaction described in section 332.

(ii) *Result.* Generally, this paragraph (d) requires that DC1 include in income the earnings and profits attributable to its stock in FC as determined under §1.1248–8. However, since the liquidation of FC into DC1 is a transaction described in §1.367(b)–3, the earnings and profits attributable to the stock of FC are limited by §1.367(b)–2(d) (3)(ii) to that portion of the earnings and profits accumulated by FC itself before or after the restructuring transaction, and do not include the earnings and profits of FC's subsidiaries accumulated before or after the restructuring transaction. Thus, DC1 will include $40 of earnings and profits in income (80% of the $50 of earnings and profits accumulated by FC after the restructuring transaction).

(e) [Reserved] For further guidance, see §1.367(b)–4T(e).

(f) [Reserved] For further guidance, see §1.367(b)–4T(f).

(g) [Reserved] For further guidance, see §1.367(b)–4T(g).

[T.D. 8862, 65 FR 3603, Jan. 24, 2000; 65 FR 66501, Nov. 6, 2000, as amended by T.D. 9243, 71 FR 4288, Jan. 26, 2006; T.D. 9250, 71 FR 8804, Feb. 21, 2006; T.D. 9311, 72 FR 5183, Feb. 5, 2007; T.D. 9345, 72 FR 41444, July 30, 2007; T.D. 9444, 74 FR 6826, Feb. 11, 2009; T.D. 9446, 74 FR 6958, Feb. 11, 2009; T.D. 9614, 78 FR 17039, Mar. 19, 2013; T.D. 9760, 81 FR 15161, Mar. 22, 2016]

§1.367(b)–4T Acquisition of foreign corporate stock or assets by a foreign corporation in certain nonrecognition transactions (temporary).

(a) through (d) [Reserved] For further guidance, see §1.367(b)–4(a) through (d).

(e) Application of section 367(b) to transactions described in section 304(a)(1)—(1) *Scope and general rule.* This section applies to the extent that, pursuant to section 304(a)(1), an exchanging shareholder is treated as transferring the stock of a foreign acquired corporation to a foreign acquiring corporation in a transaction to which section 351(a) applies (deemed section 351 exchange). Except to the extent provided in paragraph (e)(2) of this section, a transfer of stock of a foreign acquired corporation by an exchanging shareholder in a deemed section 351 exchange shall not be subject to paragraph (b) of this section.

(2) *Special rule.* Notwithstanding paragraph (e)(1) of this section, a transfer of stock of a foreign acquired corporation by an exchanging shareholder to a foreign acquiring corporation in a deemed section 351 exchange shall be subject to paragraph (b) of this section to the extent the distribution received by the exchanging shareholder in redemption of the stock of the foreign acquiring corporation is applied against and reduces, pursuant to section 301(c)(2), the basis of stock of the foreign acquiring corporation held by the exchanging shareholder other than the stock deemed issued by the foreign acquiring corporation in the deemed section 351 exchange.

(3) *Allocation of income inclusion.* If the income inclusion resulting from the application of paragraph (e)(2) of this section is less than the section 1248 amount attributable to the shares of stock of the foreign acquired corporation transferred by the exchanging

shareholder in the deemed section 351 exchange, the amount of the income inclusion attributable to each share of stock transferred in the deemed section 351 exchange shall be determined by multiplying the income inclusion by the percentage that the section 1248 amount attributable to such share of stock bears to the aggregate section 1248 amount attributable to all of the shares of stock transferred in the deemed section 351 exchange.

(4) *Example.* The rules of this paragraph (e) are illustrated by the following example:

Example. (i) *Facts.* (A) FP, a foreign corporation, wholly owns USP, a domestic corporation. USP wholly owns CFC1, and CFC1 wholly owns CFC2. CFC2 wholly owns CFC3. CFC1, CFC2 and CFC3 are controlled foreign corporations within the meaning of section 957(a). USP, CFC1, CFC2 and CFC3 use a calendar taxable year. CFC1 owns 30% of the outstanding stock of FS, a foreign corporation. FP owns the remaining 70% of the outstanding stock of FS. The CFC2 stock has a $40x basis and $100x fair market value. The FS stock held by CFC1 has a $60x basis and $100x fair market value. As of December 31, year 1, CFC2 has $20x of section 1248 earnings and profits, CFC3 has $40x of section 1248 earnings and profits, and FS has zero earnings and profits. On December 31, year 1, in a transaction described in section 304(a)(1), CFC1 sells the CFC2 stock to FS for $100x cash. FS is not a controlled foreign corporation (within the meaning section 957(a)) either before or after the sale of the CFC2 stock.

(B) Because CFC1 wholly owns CFC2 before the transaction and is treated, under section 318, as indirectly owning 100% of the CFC2 stock after the transaction, under section 304(a)(1), CFC2 and FS are treated as if CFC1 contributed the CFC2 stock to FS in a deemed section 351 exchange in exchange solely for $100x of FS stock, and then FS redeemed for $100x cash its stock deemed issued to CFC1. Because CFC1 wholly owned CFC2 before the transaction and is treated, under section 318, as indirectly owning 100% of CFC2 after the transaction, section 302(a) does not apply to the redemption. Instead, under section 302(d), the redemption is treated as a distribution to which section 301 applies. Pursuant to section 304(b)(2), $20x of the distribution is treated as a dividend from the earnings and profits of CFC2. With respect to the remaining $80x, CFC1 takes the position that $40x is applied against and reduces the basis of the FS stock deemed issued in the transaction, and $40x is applied against and reduces the basis of the FS stock held by CFC1 prior to (and after) the transaction.

(ii) *Analysis.* Under paragraph (e)(2) of this section, the transfer by CFC1 of the CFC2 stock to FS in the deemed section 351 exchange is subject to paragraph (b) of this section to the extent the distribution received by CFC1 in redemption of the FS stock issued in the deemed section 351 exchange is applied against and reduces, under section 301(c)(2), the basis of the FS stock held by CFC1 before (and after) the transaction. Thus, because $40x of the distribution received by CFC1 from FS in redemption of the FS stock issued in the deemed section 351 exchange is applied against and reduces, under section 301(c)(2), the basis of the FS stock held by CFC1 before (and after) the transaction, under paragraph (b) of this section, CFC1 must include $40x in income as a deemed dividend. See §1.367(b)–2(e) for the treatment of the $40x income inclusion. In total, CFC1 recognizes dividend income of $60x, $20x from the application of section 304(a)(1) to the sale of the CFC2 stock to FS and $40x under paragraph (b) of this section by reason of the application of paragraph (e)(2) of this section.

(f) *Effective/applicability date.* Paragraph (e) of this section applies to transfers occurring on or after February 10, 2009. See §1.367(b)–4, as contained in 26 CFR part 1 revised as of April 1, 2008, for transfers occurring on or after February 21, 2006, and before February 10, 2009.

(g) *Expiration date.* This section expires on or before February 10, 2012.

[T.D. 9444, 74 FR 6826, Feb. 11, 2009]

§1.367(b)–5 Distributions of stock described in section 355.

(a) *In general*—(1) *Scope.* This section provides rules relating to a distribution described in section 355 (or so much of section 356 as relates to section 355) and to which section 367(b) applies. For purposes of this section, the terms *distributing corporation*, *controlled corporation*, and *distributee* have the same meaning as used in section 355 and the regulations thereunder.

(2) *Treatment of distributees as exchanging shareholders.* For purposes of the section 367(b) regulations, all distributees in a transaction described in paragraph (b), (c), or (d) of this section shall be treated as exchanging shareholders that realize income in a section 367(b) exchange.

(b) *Distribution by a domestic corporation*—(1) *General rule.* In a distribution described in section 355, if the distributing corporation is a domestic corporation and the controlled corporation is a foreign corporation, the following general rules shall apply—

(i) If the distributee is a corporation, then the controlled corporation shall be considered to be a corporation; and

(ii) If the distributee is an individual, then, solely for purposes of determining the gain recognized by the distributing corporation, the controlled corporation shall not be considered to be a corporation, and the distributing corporation shall recognize any gain (but not loss) realized on the distribution.

(2) *Section 367(e) transactions.* The rules of paragraph (b)(1) of this section shall not apply to a foreign distributee to the extent gain is recognized under section 367(e)(1) and the regulations thereunder.

(3) *Determining whether distributees are individuals.* All distributees in a distribution described in paragraph (b)(1) of this section are presumed to be individuals. However, the shareholder identification principles of §1.367(e)–1(d) (including the reporting procedures in §1.367(e)–1(d)(2) and (3)) shall apply for purposes of rebutting this presumption.

(4) *Applicable cross-references.* For rules with respect to a distributee that is a partnership, trust or estate, see §1.367(b)–2(k). For additional rules relating to a distribution of stock of a foreign corporation by a domestic corporation, see section 1248(f) and the regulations thereunder. For additional rules relating to a distribution described in section 355 by a domestic corporation to a foreign distributee, see section 367(e)(1) and the regulations thereunder.

(c) *Pro rata distribution by a controlled foreign corporation*—(1) *Scope.* This paragraph (c) applies to a distribution described in section 355 in which the distributing corporation is a controlled foreign corporation and in which the stock of the controlled corporation is distributed pro rata to each of the distributing corporation's shareholders.

(2) *Adjustment to basis in stock and income inclusion.* If the distributee's postdistribution amount (as defined in paragraph (e)(2) of this section) with respect to the distributing or controlled corporation is less than the distributee's predistribution amount (as defined in paragraph (e)(1) of this section) with respect to such corporation, then the distributee's basis in such stock immediately after the distribution (determined under the normal principles of section 358) shall be reduced by the amount of the difference. However, the distributee's basis in such stock shall not be reduced below zero, and to the extent the foregoing reduction would have reduced basis below zero, the distributee shall instead include such amount in income as a deemed dividend from such corporation.

(3) *Interaction with §1.367(b)–2(e)(3)(ii).* The basis increase provided in §1.367(b)–2(e)(3)(ii) shall not apply to a deemed dividend that is included in income pursuant to paragraph (c)(2) of this section.

(4) *Basis redistribution.* If a distributee reduces the basis in the stock of the distributing or controlled corporation (or has an inclusion with respect to such stock) under paragraph (c)(2) of this section, the distributee shall increase its basis in the stock of the other corporation by the amount of the basis decrease (or deemed dividend inclusion) required by paragraph (c)(2) of this section. However, the distributee's basis in such stock shall not be increased above the fair market value of such stock and shall not be increased to the extent the increase diminishes the distributee's postdistribution amount with respect to such corporation.

(d) *Non-pro rata distribution by a controlled foreign corporation*—(1) *Scope.* This paragraph (d) applies to a distribution described in section 355 in which the distributing corporation is a controlled foreign corporation and in which the stock of the controlled corporation is not distributed pro rata to each of the distributing corporation's shareholders.

(2) *Treatment of certain shareholders as distributees.* For purposes of the section 367(b) regulations, all persons owning stock of the distributing corporation

immediately after a transaction described in paragraph (d)(1) of this section shall be treated as distributees of such stock. For other applicable rules, see paragraph (a)(2) of this section.

(3) *Inclusion of excess section 1248 amount by exchanging shareholder.* If the distributee's postdistribution amount (as defined in paragraph (e)(2) of this section) with respect to the distributing or controlled corporation is less than the distributee's predistribution amount (as defined in paragraph (e)(1) of this section) with respect to such corporation, then the distributee shall include in income as a deemed dividend the amount of the difference. For purposes of this paragraph (d)(3), if a distributee owns no stock in the distributing or controlled corporation immediately after the distribution, the distributee's postdistribution amount with respect to such corporation shall be zero.

(4) *Interaction with § 1.367(b)–2(e)(3)(ii)*—(i) *Limited application.* The basis increase provided in § 1.367(b)–2(e)(3)(ii) shall apply to a deemed dividend that is included in income pursuant to paragraph (d)(3) of this section only to the extent that such basis increase does not increase the distributee's basis above the fair market value of such stock and does not diminish the distributee's postdistribution amount with respect to such corporation.

(ii) *Interaction with predistribution amount.* For purposes of this paragraph (d), the distributee's predistribution amount (as defined in paragraph (e)(1) of this section) shall be determined without regard to any basis increase permitted under paragraph (d)(4)(i) of this section.

(e) *Definitions*—(1) *Predistribution amount.* For purposes of this section, the predistribution amount with respect to a distributing or controlled corporation is the distributee's section 1248 amount (as defined in § 1.367(b)–2(c)(1)) computed immediately before the distribution (and after any section 368(a)(1)(D) transfer connected with the section 355 distribution), but only to the extent that such amount is attributable to the distributing corporation and any corporations controlled by it immediately before the distribution (the distributing group) or the controlled corporation and any corporations controlled by it immediately before the distribution (the controlled group), as the case may be, under the principles of §§ 1.1248–1(d)(3), 1.1248–2 and 1.1248–3. However, the predistribution amount with regard to the distributing group shall be computed without taking into account the distributee's predistribution amount with respect to the controlled group.

(2) *Postdistribution amount.* For purposes of this section, the postdistribution amount with respect to a distributing or controlled corporation is the distributee's section 1248 amount (as defined in § 1.367(b)–2(c)(1)) with respect to such stock, computed immediately after the distribution (but without regard to paragraph (c) or (d) of this section (whichever is applicable)). The postdistribution amount under this paragraph (e)(2) shall be computed before taking into account the effect (if any) of any inclusion under section 356(a) or (b).

(f) *Exclusion of deemed dividend from foreign personal holding company income.* In the event an amount is included in income as a deemed dividend by a foreign corporation under paragraph (c) or (d) of this section (including amounts received as an intermediate owner under the rule of § 1.367(b)–2(e)(2)), such deemed dividend shall not be included as foreign personal holding company income under section 954(c).

(g) *Examples.* The following examples illustrate the rules of this section:

Example 1. (i) *Facts.* USS, a domestic corporation, owns 40 percent of the outstanding stock of FD, a controlled foreign corporation (CFC). USS has owned the stock since FD was incorporated, and FD has always been a CFC. USS has a basis of $80 in its FD stock, which has a fair market value of $200. FD owns 100 percent of the outstanding stock of FC, a foreign corporation. FD has owned the stock since FC was incorporated. Neither FD nor FC own stock in any other corporation. FD has earnings and profits of $0 and a fair market value of $250 (not considering its ownership of FC). FC has earnings and profits of $300, none of which is described in section 1248(d), and a fair market value of $250. In a pro rata distribution described in section 355, FD distributes to USS stock in FC worth $100; thereafter, USS's FD stock is worth $100 as well.

(ii) *Result*—(A) FD's distribution is a transaction described in paragraph (c)(1) of this section. Under paragraph (c)(2) of this section, USS must compare its predistribution amounts with respect to FD and FC to its respective postdistribution amounts. Under paragraph (e)(1) of this section, USS's predistribution amount with respect to FD or FC is its section 1248 amount computed immediately before the distribution, but only to the extent such amount is attributable to FD or FC. Under §1.367(b)–2(c)(1), USS's section 1248 amount computed immediately before the distribution is $120, all of which is attributable to FC. Thus, USS's predistribution amount with respect to FD is $0, and its predistribution amount with respect to FC is $120. These amounts are computed as follows: If USS had sold its FD stock immediately before the transaction, it would have recognized $120 of gain ($200 fair market value $80 basis). All of the gain would have been treated as a dividend under section 1248, and all of the section 1248 amount would have been attributable to FC (based on USS's pro rata share of FC's earnings and profits (40 percent × $300)).

(B) Under paragraph (e)(2) of this section, USS's postdistribution amount with respect to FD or FC is its section 1248 amount with respect to such corporation, computed immediately after the distribution (but without regard to paragraph (c) of this section). Under §1.367(b)–2(c)(1), USS's section 1248 amounts computed immediately after the distribution with respect to FD and FC are $0 and $60, respectively. These amounts, which are USS's postdistribution amounts, are computed as follows: Under the normal principles of section 358, USS allocates its $80 predistribution basis in FD between FD and FC according to the stock blocks' relative values, yielding a $40 basis in each block. If USS sold its FD stock immediately after the distribution, none of the resulting gain would be treated as a dividend under section 1248. If USS sold its FC stock immediately after the distribution, it would have a $60 gain ($100 fair market value—$40 basis), all of which would be treated as a dividend under section 1248.

(C) The basis adjustment and income inclusion rules of paragraph (c)(2) of this section apply to the extent of any difference between USS's postdistribution and predistribution amounts. In the case of FD, there is no difference between the two amounts and, as a result, no adjustment or income inclusion is required. In the case of FC, USS's postdistribution amount is $60 less than its predistribution amount. Accordingly, under paragraph (c)(2) of this section, USS is required to reduce its basis in its FC stock from $40 to $0 and include $20 in income as a deemed dividend. Under §1.367(b)–2(e)(2), the $20 deemed dividend is considered as having been paid by FC to FD, and by FD to USS, immediately prior to the distribution. Under paragraph (f) of this section, the deemed dividend is not included by FD as foreign personal holding company income under section 954(c). Under paragraph (c)(3) of this section, the basis increase provided in §1.367(b)–2(e)(3)(ii) does not apply with regard to the $20 deemed dividend. Under the rules of paragraph (c)(4) of this section, USS increases its basis in FD by the amount by which it decreased its basis in FC, as well as by the amount of its deemed dividend inclusion ($40 + $40 + $20 = $100).

Example 2. (i) *Facts.* USS1 and USS2, domestic corporations, each own 50 percent of the outstanding stock of FD, a controlled foreign corporation (CFC). USS1 and USS2 have owned their FD stock since it was incorporated, and FD has always been a CFC. USS1 and USS2 each have a basis of $500 in their FD stock, and the fair market value of each block of FD stock is $750. FD owns 100 percent of the outstanding stock of FC, a foreign corporation. FD owned the stock since FC was incorporated. Neither FD nor FC own stock in any other corporation. FD has earnings and profits of $0 and a fair market value of $750 (not considering its ownership of FC). FC has earnings and profits of $500, none of which is described in section 1248(d), and a fair market value of $750. In a non-pro rata distribution described in section 355, FD distributes all of the stock of FC to USS2 in exchange for USS2's FD stock.

(ii) *Result*—(A) FD's distribution is a transaction described in paragraph (d)(1) of this section. Under paragraph (d)(2) of this section, USS1 is considered a distributee of FD stock. Under paragraph (d)(3) of this section, USS1 and USS2 must compare their predistribution amounts with respect to FD and FC stock to their respective postdistribution amounts. Under paragraph (e)(1) of this section, USS1's predistribution amount with respect to FD or FC is USS1's section 1248 amount computed immediately before the distribution, but only to the extent such amount is attributable to FD or FC. USS2's predistribution amount is determined in the same manner. Under §1.367(b)–2(c)(1), USS1 and USS2 each have a section 1248 amount computed immediately before the distribution of $250, all of which is attributable to FC. Thus, USS1 and USS2 each have a predistribution amount with respect to FD of $0, and each have a predistribution amount with respect to FC of $250. These amounts are computed as follows: If either USS1 or USS2 had sold its FD stock immediately before the transaction, it would have recognized $250 of gain ($750 fair market value—$500 basis). All of the gain would have been treated as a dividend under section 1248, and all of the section 1248 amount would have been attributable to FC (based on USS1's and USS2's pro rata shares of FC's earnings and profits (50 percent × $500)).

(B) Under paragraph (d)(3) of this section, a distributee that owns no stock in the distributing or controlled corporation immediately after the distribution has a postdistribution amount with regard to that stock of zero. Accordingly, USS2 has a postdistribution amount of $0 with respect to FD and USS1 has a postdistribution amount of $0 with respect to FC. Under paragraph (e)(2) of this section, USS1's postdistribution amount with respect to FD is its section 1248 amount with respect to such corporation, computed immediately after the distribution (but without regard to paragraph (d) of this section). USS2's postdistribution amount with respect to FC is determined in the same manner. Under §1.367(b)–2(c)(1), USS1's section 1248 amount computed immediately after the distribution with respect to FD is $0 and USS2's section 1248 amount computed immediately after the distribution with respect to FC is $250. These amounts, which are USS1's and USS2's postdistribution amounts, are computed as follows: After the non-pro rata distribution, USS1 owns all the stock of FD and USS2 owns all the stock of FC. If USS1 sold its FD stock immediately after the distribution, none of the resulting $250 gain ($750 fair market value $500 basis) would be treated as a dividend under section 1248. If USS2 sold its FC stock immediately after the distribution, it would have a $250 gain ($750 fair market value—$500 basis), all of which would be treated as a dividend under section 1248.

(C) The income inclusion rule of paragraph (d)(3) of this section applies to the extent of any difference between USS1's and USS2's postdistribution and predistribution amounts. In the case of USS2, there is no difference between the two amounts with respect to either FD or FC and, as a result, no income inclusion is required. In the case of USS1, there is no difference between the two amounts with respect to its FD stock. However, USS1's postdistribution amount with respect to FC is $250 less than its predistribution amount. Accordingly, under paragraph (d)(3) of this section, USS1 is required to include $250 in income as a deemed dividend. Under §1.367(b)–2(e)(2), the $250 deemed dividend is considered as having been paid by FC to FD, and by FD to USS1, immediately prior to the distribution. This deemed dividend increases USS1's basis in FD ($500 + $250 = $750). Under paragraph (f) of this section, the deemed dividend is not included by FD as foreign personal holding company income under section 954(c).

[T.D. 8862, 65 FR 3606, Jan. 24, 2000; 65 FR 66502, Nov. 6, 2000]

§ 1.367(b)–6 Effective/applicability dates and coordination rules.

(a) *Effective/applicability dates*—(1) *In general.* (i) Except as otherwise provided in this paragraph (a)(1) and paragraph (a)(2) of this section, §§1.367(b)–1 through 1.367(b)–5, and this section, apply to section 367(b) exchanges that occur on or after February 23, 2000.

(ii) The rules of §§1.367(b)–3 and 1.367(b)–4, as they apply to reorganizations described in section 368(a)(1)(A) (including reorganizations described in section 368(a)(2)(D) or (a)(2)(E)) involving a foreign acquiring or foreign acquired corporation, apply only to transfers occurring on or after January 23, 2006.

(iii) The second sentence of paragraph §1.367(b)–4(a) applies to section 304(a)(1) transactions occurring on or after February 23, 2006; however, taxpayers may rely on this sentence for all section 304(a)(1) transactions occurring in open taxable years.

(iv) Section 1.367(b)–1(c)(2)(v), (c)(3)(ii)(A), (c)(4)(iv), (c)(4)(v), §1.367(b)–2(j)(1)(i) and (l), and §1.367(b)–3(e) and (f), apply to section 367(b) exchanges that occur on or after November 6, 2006. For guidance with respect to §1.367(b)–1(c)(3)(ii)(A), (c)(4)(iv), and (c)(4)(v) and §1.367(b)–2(j)(1)(i) for exchanges that occur before November 6, 2006, see 26 CFR part 1 revised as of April 1, 2006.

(v) Section 1.367(b)–4(a), §1.367(b)–4(b)(1)(i)(B)(*2*), §1.367(b)–4(b)(1)(ii), §1.367(b)–4(b)(1)(iii), *Example 4* and *Example 5* apply to section 367(b) exchanges that occur on or after April 18, 2013. For guidance with respect to §1.367(b)–4(a), §1.367(b)–4(b)(1)(i)(B)(*2*), §1.367(b)–4(b)(1)(ii) and §1.367(b)–4(b)(1)(iii), *Example 4*, for exchanges that occur before April 18, 2013, see 26 CFR part 1 revised as of April 1, 2012.

(2) *Exception.* A taxpayer may, however, elect to have §§1.367(b)–1 through 1.367(b)–5, and this section, apply to section 367(b) exchanges that occur (or occurred) before February 23, 2000, if the due date for the taxpayer's timely filed Federal tax return (including extensions) for the taxable year in which the section 367(b) exchange occurs (or occurred) is after February 23, 2000. The election under this paragraph (a)(2) will be valid only if—

(i) The electing taxpayer makes the election on a timely filed section 367(b) notice;

(ii) In the case of an exchanging shareholder that is a foreign corporation, the election is made on the section 367(b) notice that is filed by each of its shareholders listed in §1.367(b)–1(c)(3)(ii); and

(iii) The electing taxpayer provides notice of the election to all corporations (or their successors in interest) whose earnings and profits are affected by the election on or before the date the section 367(b) notice is filed.

(b) *Certain recapitalizations described in §1.367(b)–4(b)(3).* In the case of a recapitalization described in §1.367(b)–4(b)(3) that occurred prior to July 20, 1998, the exchanging shareholder shall include the section 1248 amount on its tax return for the taxable year that includes the exchange described in §1.367(b)–4(b)(3)(i) (and not in the taxable year of the recapitalization), except that no inclusion is required if both the recapitalization and the exchange described in §1.367(b)–4(b)(3)(i) occurred prior to July 20, 1998.

(c) *Use of reasonable method to comply with prior published guidance*—(1) *Prior exchanges.* The taxpayer may use a reasonable method to comply with the following prior published guidance to the extent such guidance relates to section 367(b): Notice 88–71 (1988–2 C.B. 374); Notice 89–30 (1989–1 C.B. 670); and Notice 89–79 (1989–2 C.B. 392) (see §601.601(d)(2) of this chapter). This rule applies to section 367(b) exchanges that occur (or occurred) before February 23, 2000, or, if a taxpayer makes the election described in paragraph (a)(2) of this section, for section 367(b) exchanges that occur (or occurred) before the date described in paragraph (a)(2) of this section. This rule also applies to section 367(b) exchanges and distributions described in paragraph (d) of this section.

(2) *Future exchanges.* Section 367(b) exchanges that occur on or after February 23, 2000, (or, if a taxpayer makes the election described in paragraph (a)(2) of this section, for section 367(b) exchanges that occur on or after the date described in paragraph (a)(2) of this section) are governed by the section 367(b) regulations and, as a result, paragraph (c)(1) of this section shall not apply.

(d) *Effect of removal of attribution rules.* To the extent that the rules under §§7.367(b)–9 and 7.367(b)–10(h) of this chapter, as in effect prior to February 23, 2000 (see 26 CFR part 1, revised as of April 1, 1999), attributed earnings and profits to the stock of a foreign corporation in connection with an exchange described in section 351, 354, 355, or 356 before February 23, 2000, the foreign corporation shall continue to be subject to the rules of §7.367(b)–12 of this chapter in the event of any subsequent exchanges and distributions with respect to such stock, notwithstanding the fact that such subsequent exchange or distribution occurs on or after the effective date described in paragraph (a) of this section.

[T.D. 8862, 65 FR 3608, Jan. 24, 2000, as amended by T.D. 9243, 71 FR 4289, Jan. 26, 2006; T.D. 9250, 71 FR 8805, Feb. 21, 2006; T.D. 9243, 71 FR 28266, May 16, 2006; T.D. 9273, 71 FR 44895, Aug. 8, 2006; 73 FR 14386, Mar. 18, 2008; T.D. 9614, 78 FR 17041, Mar. 19, 2013]

§1.367(b)–7 Carryover of earnings and profits and foreign income taxes in certain foreign-to-foreign nonrecognition transactions.

(a) *Scope.* This section applies to an acquisition by a foreign corporation (foreign acquiring corporation) of the assets of another foreign corporation (foreign target corporation) in a transaction described in section 381 (foreign section 381 transaction). This section describes the manner and extent to which earnings and profits and foreign income taxes of the foreign acquiring corporation and the foreign target corporation carry over to the surviving foreign corporation (foreign surviving corporation) and the ordering of distributions by the foreign surviving corporation. See §1.367(b)–9 for special rules governing reorganizations described in section 368(a)(1)(F) and foreign section 381 transactions involving foreign corporations that hold no property and have no tax attributes immediately before the transaction, other than a nominal amount of assets (and related tax attributes).

(b) *General rules*—(1) *Non-previously taxed earnings and profits and related taxes.* Earnings and profits and related foreign income taxes of the foreign acquiring corporation and the foreign target corporation (pre-transaction

earnings and pre-transaction taxes, respectively) shall carry over to the foreign surviving corporation in the manner described in paragraphs (d), (e), and (f) of this section. Dividend distributions by the foreign surviving corporation (post-transaction distributions) shall be out of earnings and profits and shall reduce related foreign income taxes in the manner described in paragraph (c) of this section.

(2) *Previously taxed earnings and profits.* [Reserved]

(c) *Ordering rule for post-transaction distributions.* Dividend distributions out of a foreign surviving corporation's earnings and profits shall be ordered in accordance with the rules of paragraph (c)(1) or (2) of this section, depending on whether the foreign surviving corporation is a pooling corporation or a nonpooling corporation.

(1) *If foreign surviving corporation is a pooling corporation.* In the case of a foreign surviving corporation that is a pooling corporation, post-transaction distributions shall be first out of the post-1986 pool (as described in paragraph (d) of this section) and second out of the pre-pooling annual layers (as described in paragraph (e)(1) of this section) under an annual last-in, first-out (LIFO) method.

(2) *If foreign surviving corporation is a nonpooling corporation.* In the case of a foreign surviving corporation that is a nonpooling corporation, post-transaction distributions shall be out of the pre-pooling annual layers (as described in paragraph (e)(2) of this section) under the LIFO method.

(d) *Post-1986 pool.* If the foreign surviving corporation is a pooling corporation, then the post-1986 pool shall be determined under the rules of this paragraph (d).

(1) *In general*—(i) *Qualifying earnings and taxes.* The post-1986 pool shall consist of the post-1986 undistributed earnings and related post-1986 foreign income taxes of the foreign acquiring corporation and the foreign target corporation.

(ii) *Carryover rule.* Subject to paragraph (d)(2) of this section, the amounts described in paragraph (d)(1)(i) of this section attributable to the foreign acquiring corporation and the foreign target corporation shall carry over to the foreign surviving corporation and shall be combined on a separate category-by-separate category basis.

(2) *Hovering deficit*—(i) *In general.* If immediately prior to the foreign section 381 transaction either the foreign acquiring corporation or the foreign target corporation has a deficit in one or more separate categories of post-1986 undistributed earnings or an aggregate deficit in pre-1987 accumulated profits, such deficit will be a hovering deficit of the foreign surviving corporation. The rules of this paragraph (d)(2) apply to hovering deficits in separate categories of post-1986 undistributed earnings. See paragraphs (e)(1)(iii) and (e)(2)(iii) of this section for rules that apply to hovering deficits in pre-1987 accumulated profits. If the foreign acquiring corporation and the foreign target corporation each have a post-1986 hovering deficit in the same separate category of post-1986 undistributed earnings, such deficits and their related post-1986 foreign income taxes shall be combined for purposes of applying this paragraph (d)(2). See also paragraphs (f)(1) and (4) of this section (describing other rules applicable to a deficit described in this paragraph (d)(2)).

(ii) *Offset rule.* A hovering deficit in a separate category of post-1986 undistributed earnings shall offset only earnings and profits accumulated by the foreign surviving corporation after the foreign section 381 transaction (post-transaction earnings) in the same separate category of post-1986 undistributed earnings. For purposes of this rule, however, post-transaction earnings do not include post-1986 undistributed earnings in the same category that are earned after the foreign section 381 transaction, but are distributed or deemed distributed in the same year they are earned (that is, that do not become accumulated). The offset shall occur as of the first day of the foreign surviving corporation's first taxable year following the year in which the post-transaction earnings accumulated.

(iii) *Related taxes.* Post-1986 foreign income taxes that are related to a hovering deficit in a separate category of post-1986 undistributed earnings shall

only be added to the foreign surviving corporation's post-1986 foreign income taxes in that separate category on a pro rata basis as the hovering deficit is absorbed. Pro rata means in the same proportion as the portion of the hovering deficit that offsets post-transaction earnings in the separate category under paragraph (d)(2)(ii) of this section bears to the total amount of the hovering deficit.

(3) *Examples.* The following examples illustrate the rules of this paragraph (d). The examples assume the following facts: Foreign corporations A and B are controlled foreign corporations (CFCs) that were incorporated after December 31, 1986, have always been pooling corporations, and have always had calendar taxable years. None of the shareholders of foreign corporations A and B are required to include any amount in income under §1.367(b)–4 as a result of the foreign section 381 transaction. Foreign corporations A and B (and all of their respective qualified business units as defined in section 989) maintain a ''u'' functional currency. Finally, unless otherwise stated, any post-1986 undistributed earnings in the passive category resulted from a look-through dividend that was paid by a lower-tier CFC out of earnings accumulated when the CFC was a noncontrolled section 902 corporation and that qualified for the subpart F same-country exception under section 954(c)(3)(A). The examples are as follows:

Example 1. (i) *Facts.* (A) On December 31, 2006, foreign corporations A and B have the following post-1986 undistributed earnings and post-1986 foreign income taxes:

Separate category	E&P	Foreign taxes
Foreign Corporation A		
General	300u	$60
Passive	100u	40
	400u	$100
Foreign Corporation B		
General	300u	$70

(B) On January 1, 2007, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign section 381 transaction, foreign surviving corporation is a CFC.

(ii) *Result.* Under the rules described in paragraph (d)(1) of this section, foreign surviving corporation has the following post-1986 undistributed earnings and post-1986 foreign income taxes:

Separate category	E&P	Foreign taxes
General	600u	$130
Passive	100u	40
	700u	$170

(iii) *Post-transaction distribution.* (A) During 2007, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2007, foreign surviving corporation distributes 350u to its shareholders. Under the rules described in §1.902–1(d)(1) and paragraph (c)(1) of this section, the distribution is out of, and reduces, post–1986 undistributed earnings and post-1986 foreign income taxes in the separate categories on a pro rata basis, as follows:

Separate category	E&P	Foreign taxes
General	300u	$65
Passive	50u	20
	350u	$85

(B) The foreign income taxes deemed paid by qualifying shareholders of foreign surviving corporation upon the distribution are subject to generally applicable rules and limitations, such as those of sections 78, 902, and 904(d).

(C) Immediately after the distribution, foreign surviving corporation has the following post-1986 undistributed earnings and post-1986 foreign income taxes:

Separate category	E&P	Foreign taxes
General	300u	$65
Passive	50u	20
	350u	$85

Example 2. (i) *Facts.* (A) On December 31, 2006, foreign corporations A and B have the following post-1986 undistributed earnings and post-1986 foreign income taxes:

Separate category	E&P	Foreign taxes
Foreign Corporation A		
General	200u	$30
Passive	(100u)	10
	100u	$40
Foreign Corporation B		
General	300u	$60

Separate category	E&P	Foreign taxes
Passive	100u	30
	400u	$90

(B) On January 1, 2007, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign section 381 transaction, foreign surviving corporation is a CFC.

(ii) *Result.* Under the rules described in paragraphs (d)(1) and (2) of this section, foreign surviving corporation has the following post-1986 undistributed earnings and post-1986 foreign income taxes:

Separate category	Earnings & profits		Foreign taxes	
	Positive E&P	Hovering deficit	Foreign taxes available	Foreign taxes associated with hovering deficit
General	500u	.....	$ 90	.....
Passive	100u	(100u)	30	$10
	600u	(100u)	$120	$10

(iii) *Post-transaction distribution.* (A) During 2007, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2007, foreign surviving corporation distributes 300u to its shareholders. Under the rules described in §1.902–1(d)(1) and paragraph (c)(1) of this section, the distribution is out of, and reduces, post-1986 undistributed earnings and post-1986 foreign income taxes on a pro rata basis as follows:

Separate category	E&P	Foreign taxes
General	250u	$45
Passive	50u	15
	300u	$60

(B) The foreign income taxes deemed paid by qualifying shareholders of foreign surviving corporation upon the distribution are subject to generally applicable rules and limitations, such as those of sections 78, 902, and 904(d).

(C) Immediately after the distribution, foreign surviving corporation has the following post-1986 undistributed earnings and post-1986 foreign income taxes:

Separate category	Earnings & profits		Foreign taxes	
	Positive E&P	Hovering deficit	Foreign taxes available	Foreign taxes associated with hovering deficit
General	250u	.....	$45	.....
Passive	50u	(100u)	15	$10
	300u	(100u)	$60	$10

(iv) *Post-transaction earnings*—(A) In its taxable year ending on December 31, 2008, foreign surviving corporation accumulates earnings and profits and pays related foreign income taxes as follows:

Separate category	E&P	Foreign taxes
General	100u	$20
Passive	50u	$10
	150u	$40

(B) None of foreign surviving corporation's earnings and profits for its 2008 taxable year qualifies as subpart F income as defined in section 952(a). Under the rules described in paragraphs (d)(2)(ii) and (iii) of this section, the hovering deficit in the passive category will offset the post-transaction earnings in that category and a proportionate amount of the foreign taxes related to the hovering deficit will be added to the post-1986 foreign income taxes pool. Because the post-transaction earnings in the passive category are half of the amount of the hovering deficit, half of the related taxes are added to the post-1986 foreign income taxes pool. Accordingly, foreign surviving corporation has the

following post-1986 undistributed earnings and post-1986 foreign income taxes on January 1, 2009:

Separate category	Earnings & profits		Foreign taxes	
	Positive E&P	Hovering deficit	Foreign taxes available	Foreign taxes associated with hovering deficit
General	350u		$65	
Passive	50u	(50u)	30	$5
	400u	(50u)	$95	$5

Example 3. (i) *Facts.* The facts are the same as *Example 2*, except that the 50u of earnings in the passive category accrued by foreign surviving corporation during 2008 is subpart F income, all of which is included in income under section 951(a) by United States shareholders (as defined in section 951(b)). This example assumes that none of the United States shareholders are able to reduce their subpart F income inclusion with a qualified deficit under section 952(c)(1)(B).

(ii) *Result.* (A) Under the rule described in paragraph (f)(1) of this section, the (100u) hovering deficit in the passive category does not reduce foreign surviving corporation's current passive earnings and profits for purposes of determining subpart F income or associated deemed paid credits. Thus, foreign surviving corporation's United States shareholders include their pro rata shares of 50u in taxable income for the year and are eligible for a deemed paid foreign tax credit under section 960, computed by reference to their pro rata shares of $12.50 (50u subpart F inclusion / (50u + 50u post-1986 undistributed earnings in the passive category = 100u) = 50%, × $25 post-1986 foreign income taxes in the passive category = $12.50). The United States shareholders will also include their pro rata shares of the deemed-paid taxes of $12.50 in taxable income for the year as a deemed dividend pursuant to section 78.

(B) Immediately after the subpart F inclusion and section 960 deemed paid taxes (and taking into account the taxable year 2008 earnings and profits and related taxes in the general category), foreign surviving corporation has the following post-1986 undistributed earnings and post-1986 foreign income taxes:

Separate category	Earnings & profits		Foreign taxes available	Foreign taxes
	Positive E&P	Hovering deficit		Foreign taxes associated with hovering deficit
General	350u		$65.00	
Passive	50u	(100u)	12.50	$10
	400u	(100u)	77.50	10

(C) The 50u included as subpart F income constitutes previously taxed earnings and profits under section 959.

Example 4. (i) *Facts.* (A) On December 31, 2006, foreign corporations A and B have the following post-1986 undistributed earnings and post-1986 foreign income taxes:

Separate category	E&P	Foreign taxes
Foreign Corporation A		
General	50u	$10
Foreign Corporation B		
General	(100u)	$20

(B) On January 1, 2007, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign section 381 transaction, foreign surviving corporation is a CFC.

(ii) *Result.* (A) Under the rules described in paragraphs (d)(1) and (2) of this section, foreign surviving corporation has the following

post-1986 undistributed earnings and post-1986 foreign income taxes:

Separate category	Earnings & profits		Foreign taxes available	Foreign taxes	
	Positive E&P	Hovering deficit		Foreign taxes associated with hovering deficit	
General	50u	(100u)	$10	$20	

(iii) *Post-transaction earnings and distribution.* (A) In its taxable year ending on December 31, 2007, foreign surviving corporation earns 100u in the general category and pays related foreign income taxes of $24. On December 31, 2007, foreign surviving corporation distributes 75u to its shareholders.

(B) *Result.* For purposes of determining the dividend amount under section 316 and the foreign income taxes deemed paid with respect to that dividend under section 902, under paragraph (d)(2)(ii) of this section the hovering deficit does not offset the post-transaction current year earnings. Accordingly, the full 75u will be a dividend under section 316. The deemed paid taxes on that dividend are $17 (75u distribution / (100u current earnings + 50u accumulated earnings) = 50%, × ($10 accumulated foreign taxes + $24 current year foreign taxes) = $17). The 25u of undistributed earnings and profits in 2007 will be offset by (25u) of the hovering deficit for purposes of determining the opening balance of the post-1986 undistributed earnings pool in 2008. Because the amount of earnings offset by the hovering deficit is 25% of the amount of the hovering deficit, under paragraph (d)(2)(iii) of this section $5 (25% of $20) of the related taxes are added to the post-1986 foreign income taxes pool at the beginning of the next taxable year. Accordingly, foreign surviving corporation has the following post-1986 undistributed earnings and post-1986 foreign income taxes on January 1, 2008:

Separate category	Earnings & profits		Foreign taxes	
	Positive E&P	Hovering deficit	Foreign taxes available	Foreign taxes associated with hovering deficit
General	50u	(75u)	$22	$15

(e) *Pre-pooling annual layers*—(1) *If foreign surviving corporation is a pooling corporation.* If the foreign surviving corporation is a pooling corporation, the pre-pooling annual layers shall be determined under the rules of this paragraph (e)(1).

(i) *Qualifying earnings and taxes.* The pre-pooling annual layers shall consist of the pre-1987 accumulated profits and the pre-1987 foreign income taxes of the foreign acquiring corporation and the foreign target corporation.

(ii) *Carryover rule.* Subject to paragraph (e)(1)(iii) of this section, the amounts described in paragraph (e)(1)(i) of this section shall carry over to the foreign surviving corporation but shall not be combined. If the foreign acquiring corporation and the foreign target corporation have pre-1987 accumulated profits in the same year and a distribution is made therefrom, the rules of § 1.902–1(b)(2)(ii) and (b)(3) shall apply separately to reduce pre-1987 accumulated profits and pre-1987 foreign income taxes of the foreign acquiring corporation and the foreign target corporation on a pro rata basis. For further guidance, see Rev. Rul. 68–351 (1968–2 C.B. 307); Rev. Rul. 70–373 (1970–2 C.B. 152) (see also § 601.601(d)(2) of this chapter); see also paragraph (f)(2) of this section (governing the reconciliation of taxable years).

(iii) *Deficit*—(A) *In general.* The rules of this paragraph (e)(1)(iii) apply when, immediately prior to the foreign section 381 transaction, the foreign acquiring corporation or the foreign target corporation (or both) has a deficit in earnings and profits for one or more of the years that comprise its pre-1987

accumulated profits (see also paragraphs (f)(1) and (4) of this section, describing other rules applicable to a deficit described in this paragraph (e)(1)(iii)).

(B) *Aggregate positive pre-1987 accumulated profits.* If the foreign acquiring corporation or the foreign target corporation (or both) has an aggregate positive (or zero) amount of pre-1987 accumulated profits, but a deficit in earnings and profits for one or more years, then the rules otherwise applicable to such deficits shall apply separately to the pre-1987 accumulated profits and related pre-1987 foreign income taxes of such corporation. A deficit in pre-1987 accumulated profits for one or more years is applied to reduce pre-1987 accumulated profits on a LIFO basis. Any remaining deficit shall be applied to reduce pre-1987 accumulated profits in succeeding years. See Rev. Rul. 74–550 (1974–2 C.B. 209) (see also §601.601(d)(2) of this chapter); *Champion Int'l Corp.* v. *Commissioner*, 81 T.C. 424 (1983), acq. in result, 1987–2 C.B. 1; Rev. Rul. 87–72 (1987–2 C.B. 170) (see also §601.601(d)(2) of this chapter). As a result, no amount in excess of the aggregate positive amount of pre-1987 accumulated profits shall be distributed from the pre-transaction earnings of the foreign acquiring corporation or the foreign target corporation.

(C) *Aggregate deficit in pre-1987 accumulated profits.* If the foreign acquiring corporation or the foreign target corporation (or both) has an aggregate deficit in pre-1987 accumulated profits, a hovering deficit as defined under paragraph (d)(2)(i) of this section, then the rules under §1.902–2(b) shall apply to such hovering deficit (and related pre-1987 foreign income taxes) immediately prior to the transaction, except that the aggregate hovering deficit that is carried forward into the foreign surviving corporation's post-1986 pool shall offset only post-transaction earnings accumulated by the foreign surviving corporation in the same separate category of post-1986 undistributed earnings to which the relevant portion of the hovering deficit is attributable. Post-transaction earnings do not include earnings and profits that are earned after the foreign section 381 transaction but distributed or deemed distributed in the same year they are earned.

(D) *Deficit and positive separate categories within annual layers.* For purposes of applying the rules of paragraphs (e)(1)(iii)(B) and (C) of this section, if within a single pre-pooling annual layer, the foreign acquiring corporation or the foreign target corporation (or both) has a deficit in pre-1987 accumulated profits in a separate category and positive pre-1987 accumulated profits in another separate category, the deficit shall first be used to offset the positive pre-1987 accumulated profits in the other separate category in the same pre-pooling annual layer. Any remaining deficit shall be carried forward or back to other years according to the rules of paragraph (e)(1)(iii)(B) or (C) of this section as applicable.

(iv) *Pre-1987 section 960 earnings and profits and foreign income taxes.* The pre-1987 section 960 earnings and profits and pre-1987 section 960 foreign income taxes of the foreign acquiring corporation and the foreign target corporation shall carry over to the foreign surviving corporation but shall not be combined. The rules otherwise applicable to such amounts shall apply separately to the pre-1987 section 960 earnings and profits and pre-1987 section 960 foreign income taxes of the foreign acquiring corporation and the foreign target corporation on a pro rata basis. For further guidance, see Notice 88–70 (1988–2 C.B. 369) (see also §601.601(d)(2) of this chapter).

(v) *Examples.* The following examples illustrate the rules of this paragraph (e)(1). The examples assume the following facts: Foreign corporation A was incorporated in 2003 and was a nonpooling corporation through December 31, 2004. Foreign corporation A became a CFC on January 1, 2005 and, as a result, began to maintain a pool of post-1986 undistributed earnings on that date. Foreign corporation B was incorporated in 2003 and has always been owned by foreign shareholders (and thus never has met the requirements of section 902(c)(3)(B)). Both foreign corporation A and foreign corporation B have always had calendar taxable years. Foreign corporations A and B (and all of their respective qualified

business units as defined in section 989) maintain a ''u'' functional currency. Finally, unless otherwise stated, all earnings and profits of foreign corporations A and B are in the general category. The examples are as follows:

Example 1. (i) *Facts.* (A) On December 31, 2006, foreign corporations A and B have the following earnings and profits and foreign income taxes:

	E&P	Foreign taxes
Foreign Corporation A:		
Post-1986 pool	1,000u	$350
2004	400u	160u
2003	100u	5u
	1,500u	
Foreign Corporation B:		
2006	100u	20u
2005	150u	30u
2004	0u	50u
2003	50u	5u
	300u	105u

(B) On January 1, 2007, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign section 381 transaction, foreign surviving corporation is a CFC.

(ii) *Result.* Under the rules described in paragraphs (e)(1)(i) and (ii) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes:

	E&P	Foreign taxes
Post-1986 Pool	1,000u	$350
2006	100u	20u
2005	150u	30u
Two Side-by-Side Layers of 2004 E&P:		
2004 layer #1 (from Corp A)	400u	160u
2004 layer #2 (from Corp B)	0u	50u
Two Side-by-Side Layers of 2003 E&P:		
2003 layer #1 (from Corp A)	100u	5u
2003 layer #2 (from Corp B)	50u	5u
	1,800u	.....

(iii) *Post-transaction distribution.* (A) During 2007, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2007, foreign surviving corporation distributes 1,725u to its shareholders. Under the rules of paragraph (c)(1) of this section, the distribution is first out of the post-1986 pool, and then out of the pre-pooling annual layers under the LIFO method, as follows:

	E&P	Foreign taxes
Post-1986 pool	1,000u	$350
2006	100u	20u
2005	150u	30u
Two Side-by-Side Layers of 2004 E&P:		
2004 layer #1	400u	160u
2004 layer #2	0u	0u
Two Side-by-Side Layers of 2003 E&P:		
2003 layer #1	*50u	2.5u
2003 layer #2	**25u	2.5u
	1,725u	

*100u in layer/150u aggregate 2003 earnings = 66.67% × 75u distribution.
**50u in layer/150u aggregate 2003 earnings = 33.33% × 75u distribution.

(B) The foreign income taxes deemed paid by qualifying shareholders of foreign surviving corporation upon the distribution are subject to generally applicable rules and limitations, such as those of sections 78, 902, and 904(d).

(C) Immediately after the distribution, foreign surviving corporation has the following earnings and profits and foreign income taxes:

	E&P	Foreign taxes
2004 layer #2	0u	50u
Two Side-by-Side Layers of 2003 E&P:		
2003 layer #1	50u	2.5u
2003 layer #2	25u	2.5u
	75u	55u

(iv) *Post-transaction earnings.* For the taxable year ending on December 31, 2008, foreign surviving corporation has 500u of current earnings and profits in the general category, none of which qualify as subpart F income under section 952(a), and pays $70 in foreign income taxes. As of the close of the 2008 taxable year, foreign surviving corporation has the following earnings and profits and foreign income taxes:

	E&P	Foreign taxes
Post-1986 pool	500u	$70
2004	0u	50u
Two Side-by-Side Layers of 2003 E&P:		
2003 layer #1	50u	2.5u
2003 layer #2	25u	2.5u
	575u	

Example 2. (i) *Facts.* (A) On December 31, 2006, foreign corporations A and B have the following earnings and profits and foreign income taxes:

	E&P	Foreign taxes
Foreign Corporation A:		
Post-1986 pool	1,000u	$350
2004	100u	20u
2003	(50u)	5u

	E&P	Foreign taxes
	1,050u	
Foreign Corporation B:		
2006	100u	20u
2005	(50u)	5u
2004	0u	50u
2003	100u	10u
	150u	85u

(B) On January 1, 2007, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign section 381 transaction, foreign surviving corporation is a CFC.

(ii) *Result.* Because foreign corporations A and B have aggregate positive amounts of pre-1987 accumulated profits with a deficit in one or more years, the rules of paragraph (e)(1)(iii)(B) of this section apply. Accordingly, after the foreign section 381 transaction, foreign surviving corporation has the following earnings and profits and foreign income taxes:

	Earnings & profits		Foreign taxes	
	Positive E&P	Deficit E&P	Foreign taxes available	Foreign taxes assoicated with deficit E&P
Post-1986 pool	1,000u		$350	
2006	100u		20u	
2005		(50u)		5u
Two Side-by-Side Layers of 2004 E&P:				
2004 layer #1 (from Corp A)	100u		20u	
2004 layer #2 (from Corp B)	0u		50u	
Two Side-by-Side Layers of 2003 E&P:				
2003 layer #1 (from Corp A)		(50u)		5u
2003 layer #2 (from Corp B)	100u		10u	
	1,300u	(100u)		10u

(iii) *Post-transaction distribution.* (A) During 2007, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2007, foreign surviving corporation distributes 1,175u to its shareholders. Under the rules described in paragraphs (c)(1) and (e)(1)(iii)(B) of this section, the distribution is first out of the post-1986 pool, and then out of the pre-pooling annual layers, as follows:

Distribution	E&P	Foreign taxes
Post-1986 pool	1,000u	$350
2006	100u	20u
2005	0u	0u
Two Side-by-Side Layers of 2004 E&P:		
2004 layer #1	50u	20u
2004 layer #2	0u	0u
Two Side-by-Side Layers of 2003 E&P:		
2003 layer #1	0u	0u
2003 layer #2	25u	5u
	1,175u	

(B) Under paragraph (e)(1)(iii)(B) of this section, the rules otherwise applicable when a foreign corporation has an aggregate positive (or zero) amount of pre-1987 accumulated profits, but a deficit in one or more years, apply separately to the pre-1987 accumulated profits and related foreign income taxes of foreign corporation A and foreign corporation B. As a result, distributions out of the pre-pooling annual layers of foreign corporation A and foreign corporation B cannot exceed the aggregate positive amount of pre-1987 accumulated profits of each corporation. Accordingly, only 50u can be distributed from foreign corporation A's pre-pooling annual layers and is out of its 2004 layer #1 (after rolling forward the (50u) deficit in 2003 layer #1 to reduce earnings in 2004 layer #1 to 50u (100u − 50u)). Under the principles of §1.902–1(b)(3), the full 20u of taxes related to 2004 layer #1 is reduced or deemed paid ($20 × (50/50)). 100u is distributed from foreign corporation B's 2006 annual layer. Foreign corporation B's (50u) deficit in 2005 is then rolled back to offset its 2003 annual layer to reduce earnings in that layer to 50u, 25u of which is distributed. Thus, after the distribution, 25u remains in 2003 layer # 2 along with 5u of foreign income taxes (10u × (25u/50u)).

(C) The foreign income taxes deemed paid by qualifying shareholders of foreign surviving corporation upon the distribution are subject to generally applicable rules and limitations, such as those of sections 78, 902, and 904(d).

(D) Immediately after the distribution, foreign surviving corporation has the following earnings and profits and foreign income taxes:

	E&P	Foreign taxes
2005	0u	5u
2004 layer #2	0u	50u
Two Side-by-Side Layers of 2003 E&P:		
2003 layer #1	0u	5u
2003 layer #2	25u	5u
	25u	65u

(E) Under paragraph (e)(1)(iii)(B) of this section, the 5u, 50u, and 5u of pre-1987 foreign income taxes related to foreign surviving corporation's 2005 layer, 2004 layer #2, and 2003 layer #1, respectively, remain in those layers. These foreign income taxes generally will not be reduced or deemed paid unless a foreign tax refund restores a positive balance to the associated earnings pursuant to section 905(c), and thus will be trapped. See §1.902–2(b)(2).

Example 3. (i) Facts. (A) On December 31, 2006, foreign corporations A and B have the following earnings and profits and foreign income taxes:

	E&P	Foreign taxes
Foreign Corporation A:		
Post-1986 pool	1,000u	$350
2004	150u	20u
2003	100u	5u
	1,250u	
Foreign Corporation B:		
2006	100u	20u
2005	(250u)	5u
2004	0u	50u
2003	100u	10u
	(50u)	85u

(B) On January 1, 2007, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign section 381 transaction, foreign surviving corporation is a CFC.

(ii) *Result.* (A) Because foreign corporation B has an aggregate hovering deficit in pre-1987 accumulated profits, the rules of paragraph (e)(1)(iii)(C) of this section apply. Accordingly, §1.902–2(b) applies immediately prior to the foreign section 381 transaction, except that the hovering deficit is carried forward into the foreign surviving corporation's post-1986 undistributed earnings pool and will offset only post-transaction earnings accumulated by foreign surviving corporation in the general category. Accordingly, after the foreign section 381 transaction, foreign surviving corporation has the following earnings and profits and foreign income taxes:

	Earnings & profits		Foreign taxes	
	Positive E&P	Hovering deficit	Foreign taxes available	Foreign taxes assoicated with hovering deficit
Post-1986 pool	1,000u	(50u)	$350	$0
2006	0u		20u	
2005	0u		5u	
Two Side-by-Side Layers of 2004 E&P:				
2004 layer #1 (from Corp A)	150u		20u	
2004 layer #2 (from Corp B)	0u		50u	
Two Side-by-Side Layers of 2003 E&P:				
2003 layer #1 (from Corp A)	100u		5u	
2003 layer #2 (from Corp B)	0u		10u	
	1,250u	(50u)		$0

(B) Under paragraph (e)(1)(iii)(C) of this section, the 20u, 5u, 50u, and 10u of pre-1987 foreign income taxes associated with foreign corporation B's pre-1987 accumulated profits for 2006, 2005, 2004 layer #2, and 2003 layer #2, respectively, remain in those layers. These foreign income taxes generally will not be reduced or deemed paid unless a foreign tax refund restores a positive balance to the associated earnings pursuant to section 905(c), and thus will be trapped. See §1.902–2(b)(2).

(2) *If foreign surviving corporation is a nonpooling corporation.* If the foreign surviving corporation is a nonpooling corporation, then the pre-pooling annual layers shall be determined under the rules of this paragraph (e)(2).

(i) *Qualifying earnings and taxes.* The pre-pooling annual layers shall consist of the pre-1987 accumulated profits and the pre-1987 foreign income taxes of the foreign acquiring corporation and the foreign target corporation. If the foreign acquiring corporation or the foreign target corporation (or both) has

post-1986 undistributed earnings or a deficit in post-1986 undistributed earnings, then those earnings or deficits and any related post-1986 foreign income taxes shall be recharacterized as pre-1987 accumulated profits or deficits and pre-1987 foreign income taxes of the foreign acquiring corporation or the foreign target corporation accumulated immediately prior to the foreign section 381 transaction.

(ii) *Carryover rule.* Subject to paragraph (e)(2)(iii) of this section, the amounts described in paragraph (e)(2)(i) of this section shall carry over to the foreign surviving corporation but shall not be combined. If the foreign acquiring corporation and the foreign target corporation have pre-1987 accumulated profits in the same year and a distribution is made therefrom, the principles of §1.902–1(b)(2)(ii) and (3) shall apply separately to reduce pre-1987 accumulated profits and pre-1987 foreign income taxes of the foreign acquiring corporation and the foreign target corporation on a pro rata basis. For further guidance, see Rev. Rul. 68–351 (1968–2 C.B. 307); Rev. Rul. 70–373 (1970–2 C.B. 152) (see also §601.601(d)(2) of this chapter); see also paragraph (f)(2) of this section (governing the reconciliation of taxable years).

(iii) *Deficits*—(A) *In general.* The rules of this paragraph (e)(2)(iii) apply when, immediately prior to the foreign section 381 transaction (and after application of the last sentence of paragraph (e)(2)(i) of this section), the foreign acquiring corporation or the foreign target corporation (or both) has a deficit in one or more years that comprise its pre-1987 accumulated profits. See also paragraphs (f)(1) and (4) of this section (describing other rules applicable to a deficit described in this paragraph (e)(2)(iii)).

(B) *Aggregate positive pre-1987 accumulated profits.* If the foreign acquiring corporation or the foreign target corporation (or both) has an aggregate positive (or zero) amount of pre-1987 accumulated profits, but a deficit in pre-1987 accumulated profits in one or more years, then the rules otherwise applicable to such deficits shall apply separately to the pre-1987 accumulated profits and related foreign income taxes of such corporation. A deficit in pre-1987 accumulated profits for one or more years is applied to reduce pre-1987 accumulated profits on a LIFO basis. Any remaining deficit shall be applied to reduce pre-1987 accumulated profits in succeeding years. See Rev. Rul. 74–550 (1974–2 C.B. 209) (see also §601.601(d)(2) of this chapter); *Champion Int'l Corp.* v. *Commissioner*, 81 T.C. 424 (1983), acq. in result, 1987–2 C.B. 1; Rev. Rul. 87–72 (1987–2 C.B. 170) (see also §601.601(d)(2) of this chapter). As a result, no amount in excess of the aggregate positive amount of pre-1987 accumulated profits shall be distributed from the pre-transaction earnings of the foreign acquiring corporation or the foreign target corporation.

(C) *Aggregate deficit in pre-1987 accumulated profits.* If the foreign acquiring corporation or the foreign target corporation (or both) has an aggregate deficit in pre-1987 accumulated profits, a hovering deficit as defined under paragraph (d)(2)(i) of this section, then the rules otherwise applicable to such hovering deficits shall apply separately to the pre-transaction earnings and profits and related taxes of the relevant corporation. See, e.g., sections 316(a) and 381(c)(2)(B). Thus, any hovering deficit shall offset only post-transaction earnings accumulated by the foreign surviving corporation in the same separate category of earnings and profits to which the relevant portion of the hovering deficit is attributable. Post-transaction earnings do not include earnings and profits that are earned after the foreign section 381 transaction but distributed or deemed distributed in the same year they are earned. Following the principles of §1.902–2(b), if there is an aggregate deficit in pre-1987 accumulated profits, any related pre-1987 foreign income taxes generally will not be reduced or deemed paid unless a foreign tax refund restores a positive balance to the associated earnings pursuant to section 905(c), and creates a pre-transaction aggregate positive balance for pre-1987 accumulated profits.

(D) *Deficit and positive separate categories within annual layers.* For purposes of applying the rules of paragraphs (e)(2)(iii)(B) and (C) of this section, if within a single pre-pooling annual layer, the foreign acquiring corporation or the foreign target corporation (or both) has a deficit in pre-1987 accumulated profits in a separate category and positive pre-1987 accumulated profits in another separate category, the deficit shall first be used to offset the positive pre-1987 accumulated profits in the other separate category in the same pre-pooling annual layer. Any remaining deficit shall be carried forward or back to other years according to the rules of paragraph (e)(2)(iii)(B) or (C) as applicable.

(iv) *Pre-1987 section 960 earnings and profits and foreign income taxes.* The pre-1987 section 960 earnings and profits and pre-1987 section 960 foreign income taxes of the foreign acquiring corporation and the foreign target corporation shall carry over to the foreign surviving corporation but shall not be combined. The rules otherwise applicable to such amounts shall apply separately to the pre-1987 section 960 earnings and profits and pre-1987 section 960 foreign income taxes of the foreign acquiring corporation and the foreign target corporation on a pro rata basis. For further guidance, see Notice 88–70 (1988–2 C.B. 369) (see also §601.601(d)(2) of this chapter).

(v) *Examples.* The following examples illustrate the rules of this paragraph (e)(2). The examples assume the following facts: Both foreign corporation A and foreign corporation B have always had calendar taxable years. Foreign corporations A and B (and all of their respective qualified business units as defined in section 989) maintain a ''u'' functional currency, and 1u = US$1 at all times. Finally, unless otherwise stated, all earnings and profits of foreign corporations A and B are in the general category. The examples are as follows:

Example 1. (i) *Facts.* (A) Foreign corporations A and B both were incorporated in 2003. Nine percent of the voting stock of foreign corporation A is owned by domestic corporate shareholder C. Nine percent of the voting stock of foreign corporation B is owned by domestic corporate shareholder D. Shareholders C and D are unrelated. The remaining 91% of the voting stock of each foreign corporation is owned by unrelated foreign shareholders. Thus, neither corporation meets the requirements of section 902(c)(3)(B). On December 31, 2006, foreign corporations A and B have the following earnings and profits and foreign income taxes:

	E&P	Foreign taxes
Foreign Corporation A:		
2006	500u	350u
2005	400u	300u
2004	400u	160u
2003	100u	5u
	1,400u	815u
Foreign Corporation B:		
2006	100u	20u
2005	300u	60u
2004	0u	50u
2003	50u	5u
	450u	135u

(B) On January 1, 2007, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign section 381 transaction, foreign surviving corporation is a nonpooling corporation that does not meet the requirements of section 902(c)(3)(B).

(ii) *Result.* Under the rules described in paragraphs (e)(2)(i) and (ii) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes:

	E&P	Foreign taxes
Two Side-by-Side Layers of 2006 E&P:		
2006 layer #1 (from Corp A)	500u	350u
2006 layer #2 (from Corp B)	100u	20u
Two Side-by-Side Layers of 2005 E&P:		
2005 layer #1 (from Corp A)	400u	300u
2005 layer #2 (from Corp B)	300u	60u
Two Side-by-Side Layers of 2004 E&P:		
2004 layer #1 (from Corp A)	400u	160u
2004 layer #2 (from Corp B)	0u	50u
Two Side-by-Side Layers of 2003 E&P:		
2003 layer #1 (from Corp A)	100u	5u
2003 layer #2 (from Corp B)	50u	5u
	1,850u	950u

(iii) *Post-transaction distribution.* (A) During 2007, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2007, foreign surviving corporation distributes 600u to its shareholders. Under the rules of paragraph (c)(3) of this section, the distribution is out of pre-pooling annual layers under the LIFO method as follows:

	E&P	Foreign taxes
Two Side-by-Side Layers of 2006 E&P:		
2006 layer #1 (from Corp A) ...	500u	350u
2006 layer #2 (from Corp B) ...	100u	20u
	600u	370u

(B) Foreign surviving corporation's foreign income tax accounts are reduced to reflect the distribution of earnings and profits notwithstanding that no shareholders are eligible to claim deemed paid foreign income taxes under section 902. See §1.902–1(a)(10)(iii).

(C) Immediately after the distribution, foreign surviving corporation has the following earnings and profits and foreign income taxes:

	E&P	Foreign taxes
Two Side-by-Side Layers of 2005 E&P:		
2005 layer #1 (from Corp A) ...	400u	300u
2005 layer #2 (from Corp B) ...	300u	60u
Two Side-by-Side Layers of 2004 E&P:		
2004 layer #1 (from Corp A) ...	400u	160u
2004 layer #2 (from Corp B) ...	0u	50u
Two Side-by-Side Layers of 2003 E&P:		
2003 layer #1 (from Corp A) ...	100u	5u
2003 layer #2 (from Corp B) ...	50u	5u
	1,250u	580u

Example 2. (i) *Facts.* (A) The facts are the same as in *Example 1* (i)(A), except that foreign corporation A met the requirements of section 902(c)(3)(B) on January 1, 2005, when U.S. corporate shareholder C acquired an additional 1% of voting stock for a total ownership interest of 10%; foreign corporation A thereby became a pooling corporation. On December 31, 2006, foreign corporations A and B have the following earnings and profits and foreign income taxes:

	E&P	Foreign taxes
Foreign Corporation A:		
Post-1986 pool	900u	$650
2004	400u	160u
2003	100u	5u
	1,400u	.....
Foreign Corporation B:		
2006	100u	20u
2005	300u	60u
2004	0u	50u
2003	50u	5u
	450u	135u

(B) On January 1, 2007, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign section 381 transaction, foreign surviving corporation is a nonpooling corporation that does not meet the requirements of section 902(c)(3)(B).

(ii) *Result.* Under the rules described in paragraphs (e)(2)(i) and (ii) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes:

	E&P	Foreign taxes
Two Side-by-Side Layers of 2006 E&P:		
2006 layer #1 (from Corp A's pool)	900u	$650
2006 layer #2 (from Corp B's layer)	100u	20u
2005 (from Corp B):	300u	60u
Two Side-by-Side Layers of 2004 E&P:		
2004 layer #1 (from Corp A) ...	400u	160u
2004 layer #2 (from Corp B) ...	0u	50u
Two Side-by-Side Layers of 2003 E&P:		
2003 layer #1 (from Corp A) ...	100u	5u
2003 layer #2 (from Corp B) ...	50u	5u
	1,850u	

(iii) *Subsequent ownership change.* On July 1, 2010, USS (a domestic corporation) acquires 100% of the stock of foreign surviving corporation. Under the rules of paragraph (f)(3) of this section, foreign surviving corporation begins to pool its earnings and profits under section 902(c)(3) as of January 1, 2010. Foreign surviving corporation's earnings and profits and foreign income taxes accrued before January 1, 2010 retain their character as pre-1987 accumulated profits and pre-1987 foreign income taxes.

Example 3. (i) *Facts.* (A) The facts are the same as in *Example 2*(i)(A), except that on December 31, 2006, foreign corporations A and B have the following earnings and profits and foreign income taxes:

	E&P	Foreign Taxes
Foreign Corporation A:		
Post-1986 pool	1,000u	$500
2004	(200u)	10u
2003	400u	5u
	1,200u	
Foreign Corporation B		
2006	300u	20u
2005	(100u)	60u
2004	0u	50u
2003	50u	5u
	250u	135u

(B) On January 1, 2007, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign section 381 transaction, foreign surviving corporation is a nonpooling corporation that does not meet the requirements of section 902(c)(3)(B).

(ii) *Result.* Because foreign corporations A and B have aggregate positive amounts of

pre-1987 accumulated profits with a deficit in one or more years, the rules of paragraph (e)(2)(iii)(B) of this section apply. Accordingly, after the foreign section 381 transaction, foreign surviving corporation has the following earnings and profits and foreign income taxes:

	Earnings & profits		Foreign taxes	
	Positive E&P	Deficit E&P	Foreign taxes available	Foreign taxes associated with deficit E&P
Two Side-by-Side Layers of 2006 E&P:				
2006 layer #1 (from Corp A's pool)	1,000u		$500	
2006 layer #2 (from Corp B's layer)	300u		20u	
2005 (from Corp B)		(100u)		60u
Two Side-by-Side Layers of 2004 E&P:				
2004 layer #1 (from Corp A)		(200u)		10u
2004 layer #2 (from Corp B)	0u		50u	
Two Side-by-Side Layers of 2003 E&P:				
2003 layer #1 (from Corp A)	400u		5u	
2003 layer #2 (from Corp B)	50u		5u	
	1,750u	(300u)		70u

(iii) *Post-transaction distribution.* (A) During 2007, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2007, foreign surviving corporation distributes 1,300u to its shareholders. Under the rules described in paragraphs (c)(3) and (e)(2)(iii)(B) of this section, the distribution is out of the pre-pooling annual layers, as follows:

	E&P	Foreign taxes
Two Side-by-Side Layers of 2006 E&P:		
2006 layer #1	1,000u	$500
2006 layer #2	250u	20u
2003 E&P:		
2003 layer #1	50u	1.25u (25% of 5u taxes)
	1,300u	

(B) Under paragraph (e)(2)(iii)(B) of this section, the rules otherwise applicable when a foreign corporation has an aggregate positive (or zero) amount of pre-1987 accumulated profits, but a deficit in one or more years, apply separately to the pre-1987 accumulated profits and related pre-1987 foreign income taxes of foreign corporation A and foreign corporation B. As a result, distributions out of the pre-pooling annual layers of foreign corporation A and foreign corporation B cannot exceed the aggregate positive amount of pre-1987 accumulated profits of each corporation. Accordingly, only 1,200u and 250u can be distributed out of foreign corporation A's and foreign corporation B's pre-pooling annual layers, respectively. Thus, 1,000u of the distribution is out of foreign corporation A's 2006 layer #1 and 250u is out of foreign corporation B's 2006 layer #2 (after rolling forward (50u) of the deficit in 2005 layer to reduce earnings in 2006 layer #1 to 250u (300u − 50u)). Under the principles of §1.902–1(b)(3), all of the taxes in each of those respective layers are reduced. The remaining 50u is distributed from foreign corporation A's 2003 layer #1 (after rolling back the (200u) deficit in 2004 layer #1 to reduce earnings in 2003 layer #1 to 200u (400u − 200u)). Thus, after the distribution, 150u remains in the 2003 layer #1 along with 3.75u of foreign income taxes (5u × (150u/200u)).

(C) Foreign surviving corporation's foreign income tax accounts are reduced to reflect the distribution of earnings and profits notwithstanding that no shareholders are eligible to claim a credit for deemed paid foreign income taxes under section 902. See §1.902–1(a)(10)(iii).

(D) Immediately after the distribution, foreign surviving corporation has the following earnings and profits and foreign income taxes:

	E&P	Foreign taxes
2005	0u	60u
Two Side-by-Side Layers of 2004 E&P:		
2004 layer #1	0u	10u
2004 layer #2	0u	50u
Two Side-by-Side Layers of 2003 E&P:		
2003 layer #1	150u	3.75u
2003 layer #2	0u	5u
	150u	128.75u

(E) Under paragraph (e)(2)(iii)(B) of this section, the 60u, 10u, 50u, and 5u of foreign income taxes related to foreign surviving corporation's 2005 layer, 2004 layer #1, 2004 layer #2, and 2003 layer #2, respectively, remain in those layers. These foreign income taxes generally will not be reduced or

deemed paid unless a foreign tax refund restores a positive balance to the associated earnings pursuant to section 905(c), and thus will be trapped. See §1.902–2(b)(2).

Example 4. (i) *Facts.* (A) The facts are the same as in *Example 2* (i)(A), except that on December 31, 2006, foreign corporations A and B have the following earnings and profits and foreign income taxes:

	E&P	Foreign Taxes
Foreign Corporation A:		
Post-1986 pool	(1,000u)	$20
2004	(200u)	10u
2003	400u	5u
	(800u)	
Foreign Corporation B:		
2006	100u	20u
2005	300u	60u
2004	0u	50u
2003	50u	5u
	450u	135u

(B) On January 1, 2007, foreign corporation A acquires the assets of foreign corporation B in a reorganization described in section 368(a)(1)(C). Immediately following the foreign section 381 transaction, foreign surviving corporation is a nonpooling corporation.

(ii) *Result.* (A) Under paragraph (e)(2)(i) of this section, foreign corporation A's post-1986 pool is recharacterized as a 2006 layer of pre-1987 accumulated profits. Because after the foreign section 381 transaction foreign corporation A has an aggregate deficit in pre-1987 accumulated profits, the rules of paragraph (e)(2)(iii)(C) of this section apply and the rules otherwise applicable apply separately to the pre-1987 accumulated profits that carry over to foreign surviving corporation from foreign corporation A. The (800u) aggregate deficit in foreign corporation A's pre-1987 accumulated profits is a hovering deficit that will offset only post-transaction earnings accumulated by foreign surviving corporation in the general category. Accordingly, after the foreign section 381 transaction, foreign surviving corporation has the following earnings and profits and foreign income taxes:

	Earnings & profits		Foreign taxes	
	Positive E&P	Deficit E&P	Foreign taxes available	Foreign taxes associated deficit E&P
Hovering deficit from Corp A's annual layers		(800u)		0
Two Side-by-Side Layers of 2006 E&P:				
2006 layer #1 (from Corp A's pool)		0u		$20
2006 layer #2 (from Corp B's layer)	100u		20u	
2005 (from Corp B)	300u		60u	
Two Side-by-Side Layers of 2004 E&P:				
2004 layer #1 (from Corp A)		0u		10u
2004 layer #2 (from Corp B)	0u		50u	
Two Side-by-Side Layers of 2003 E&P:				
2003 layer #1 (from Corp A)	0u		5u	
2003 layer #2 (from Corp B)	50u		5u	
	450u	(800u)	140u	

(B) Under paragraph (e)(2)(iii)(C) of this section, the $20, 10u, and 5u of pre-1987 foreign income taxes associated with foreign corporation A's pre-1987 accumulated profits for 2006 layer #1, 2004 layer #1, and 2003 layer #1, respectively, remain in those layers. These foreign income taxes generally will not be reduced or deemed paid unless a foreign tax refund restores a positive balance to the associated earnings pursuant to section 905(c), and thus will be trapped. See §1.902–2(b)(2).

(iii) *Post-transaction distribution.* (A) During 2007, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2007, foreign surviving corporation distributes 200u to its shareholders. Under the rules described in paragraph (e)(2)(iii)(C) of this section, no distribution can be made out of the pre-1987 accumulated profits of foreign corporation A (and the (800u) aggregate hovering deficit will offset only post-transaction earnings accumulated by foreign surviving corporation). Thus, the distribution is out of pre-pooling annual layers as follows:

	E&P	Foreign taxes paid
2006 layer #2	100u	20u
2005	100u	20u
	200u	40u

(B) Foreign surviving corporation's foreign income tax accounts are reduced to reflect

the distribution of earnings and profits notwithstanding that no shareholders are eligible to claim deemed paid foreign income taxes under section 902. See §1.902–1(a)(10)(iii).

(C) Immediately after the distribution, foreign surviving corporation has the following earnings and profits and foreign income taxes:

	Earnings & profits		Foreign taxes	
	Positive E&P	Deficit E&P	Foreign taxes available	Foreign taxes associated with deficit E&P
Hovering deficit from Corp A's annual layers		(800u)		0
Two Side-by-Side Layers of 2006 E&P:				
2006 layer #1 (from Corp A's pool)		0u		$20
2006 layer #2 (from Corp B's layer)	0u		0u	
2005 (from Corp B)	200u		40u	
Two Side-by-Side Layers of 2004 E&P:				
2004 layer #1 (from Corp A)		0u		10u
2004 layer #2 (from Corp B)	0u		50u	
Two Side-by-Side Layers of 2003 E&P:				
2003 layer #1 (from Corp A)	0u		5u	
2003 layer #2 (from Corp B)	50u		5u	
	250u	(800u)	140u	

(f) *Special rules*—(1) *Treatment of deficit*—(i) *General rule.* Any deficit described in paragraph (d)(2), (e)(1)(iii), or (e)(2)(iii) of this section shall not be taken into account in determining current or accumulated earnings and profits of a foreign surviving corporation other than to offset post-transaction accumulated earnings, as defined in paragraph (d)(2)(ii) of this section, including for purposes of calculating—

(A) The earnings and profits limitation of section 952(c)(1)(A); and

(B) The amount of the foreign surviving corporation's subpart F income as defined in section 952(a).

(ii) *Exceptions.* The rule in paragraph (i) shall not apply for purposes of calculating an earnings and profits limitation under section 952(c)(1)(B) or (C).

(iii) *Examples.* The following examples illustrate the principles of this paragraph (f)(1). The examples assume the following facts: foreign corporation A, incorporated in 2002, is and always has been a wholly owned subsidiary of USP, a domestic corporation. Foreign corporation B, incorporated in 2004, is and always has been a wholly owned subsidiary of foreign corporation A. Both foreign corporation A and foreign corporation B are organized under the laws of foreign country X and have always had a calendar taxable year. Foreign corporations A and B (and all of their respective qualified business units as defined in section 989) maintain a ''u'' functional currency. Unless otherwise stated, any earnings and profits or deficit in earnings and profits of foreign corporation A and B in the general category are attributable to subpart F income derived from foreign base company sales income. Foreign corporation C is a wholly owned subsidiary of USP2 and was organized in 2004 under the laws of foreign country Y. Foreign corporation C (and all of its qualified business units as defined in section 989) maintains a ''u'' functional currency. Earnings and profits of foreign corporation C in the general category are not attributable to subpart F income. The examples are as follows:

Example 1. (i) *Facts.* (A) On December 31, 2007, foreign corporations A and B have the following post-1986 undistributed earnings and post-1986 foreign income taxes:

	E&P	Foreign taxes
Foreign Corporation A Separate Category:		
General	(100u)	$25
Foreign Corporation B Separate Category:		
General	0u	$10

(B) On January 1, 2008, foreign corporation B elects under §301.7701–3(c) of this chapter to be disregarded as an entity separate from foreign corporation A. Accordingly, foreign corporation B is deemed to have distributed all its property to foreign corporation A in a liquidation described in section 332.

(ii) *Result.* Under the rules described in paragraphs (d)(1) and (2) of this section, foreign surviving corporation A has the following post-1986 undistributed earnings and post-1986 foreign income taxes:

Separate category	Earnings & profits:		Foreign taxes:	
	Positive E&P	Hovering deficit	Foreign taxes available	Foreign taxes associated with hovering deficit
General	0u	(100u)	$10	$25

(iii) *Post-transaction earnings and subpart F limitations.* (A) In its taxable year ending on December 31, 2008, foreign surviving corporation A earns 300u of subpart F general category income with respect to which it pays $50 in foreign income taxes. The hovering deficit of (100u) meets the requirements under section 952(c)(1)(B) and therefore is taken into account as a qualified deficit that may be used by USP to offset a portion of its income inclusion related to foreign surviving corporation A's subpart F income of 300u in the 2008 taxable year. Accordingly, USP includes 200u in taxable income for the year and is eligible for a deemed paid foreign tax credit under section 960 of $40 (200u subpart F inclusion/300 post-1986 undistributed earnings in the general category = 66.67%, × $60 foreign income taxes in the general category = $40). USP will also include the deemed paid foreign taxes of $40 in taxable income for the year as a deemed dividend pursuant to section 78. The 100u offset under section 952(c)(1)(B) does not result in a reduction of the hovering deficit for purposes of section 316 or section 902.

(B) Foreign surviving corporation A's 100u of subpart F income not included in income by USP will accumulate and be added to its post-1986 undistributed earnings as of the beginning of 2009. This 100u of post-transaction earnings will be offset by the (100u) hovering deficit. Because the amount of earnings offset by the hovering deficit is 100% of the total amount of the hovering deficit, all $25 of the related taxes are added to the post-1986 foreign income taxes pool as well. Accordingly, foreign surviving corporation A has the following post-1986 undistributed earnings and post-1986 foreign income taxes on January 1, 2009:

Separate category	Earnings & profits		Foreign taxes	
	Positive E&P	Hovering deficit	Foreign taxes available	Foreign taxes associated with hovering deficit
General	0u	(0u)	$45	$0

(C) The 200u included as subpart F income constitutes previously taxed earnings under section 959.

Example 2. (i) *Facts.* (A) On July 1, 2007, foreign corporation B elects under §301.7701–3(c) of this chapter to be disregarded as an entity separate from foreign corporation A. Accordingly, foreign corporation B is deemed to have distributed all of its property to foreign corporation A in a liquidation described in section 332.

(B) Neither foreign corporation A nor B has any post-1986 undistributed earnings or post-1986 foreign income taxes as of the beginning of the 2007 taxable year. For its short taxable year ending on June 30, 2007, foreign corporation B has the following post-1986 undistributed earnings and post-1986 foreign income taxes:

FOREIGN CORPORATION B

Separate category	E&P	Foreign taxes
General	(200u)	$30

(C) For the 2007 taxable year, foreign surviving corporation A earns a total of 200u of subpart F foreign based company sales income in the general category with respect to which it pays $40 in foreign income taxes.

(ii) *Result.* (A) Under paragraph (d)(2) of this section, foreign corporation B's (200u) deficit carries over to foreign surviving corporation A as a hovering deficit. Nevertheless, because it is a deficit of a qualified chain member for a taxable year ending within the 2007 taxable year of foreign surviving corporation A, the (200u) deficit meets the requirements under section 952(c)(1)(C)

and therefore may still be taken into account for purposes of limiting foreign surviving corporation A's subpart F income. Accordingly, foreign surviving corporation A's 200u of subpart F income for the 2007 taxable year is fully offset by the (200u) deficit of foreign corporation B, and USP will have no subpart F income inclusion for the 2007 taxable year. The offset under section 952(c)(1)(C) does not result in a reduction of the hovering deficit for purposes of section 316 or section 902. The hovering deficit may not also be taken into account under section 952(c)(1)(B).

(B) Because USP has no subpart F income inclusion, foreign surviving corporation A's subpart F earnings of 200u will accumulate and be added to its post-1986 undistributed earnings as of the beginning of 2008. Under the rules of paragraph (f)(5) of this section, a pro rata amount, in this case 50% or 100u, will be deemed to have been accumulated prior to the foreign section 381 transaction and the other 50%, or 100u, will be deemed to have been accumulated after the foreign section 381 transaction. The 100u of post-transaction earnings will be offset by (100u) of the hovering deficit for purposes of determining the opening balance of the post-1986 undistributed earnings pool in 2008. Because the amount of earnings offset by the hovering deficit is 50% of the total amount of the hovering deficit, $15 (50% of $30) of the related taxes are added to the post-1986 foreign income taxes pool as well. The 100u of pre-transaction earnings remain in the post-1986 undistributed earnings pool. Accordingly, foreign surviving corporation A has the following post-1986 undistributed earnings and post-1986 foreign income taxes on January 1, 2008:

Separate category	Earnings & profits		Foreign taxes	
	Positive E&P	Hoverinig deficit	Foreign taxes available	Foreign taxes associated with hovering deficit
General	100u	(100u)	$55	$15

Example 3. (i) *Facts.* (A) On January 1, 2007, foreign corporation B and foreign corporation C have the following post-1986 undistributed earnings and post-1986 foreign income taxes:

	E&P	Foreign taxes
Foreign Corporation B Separate Category:		
General	(100u)	$0
Foreign Corporation C Separate Category:		
General	0u	$10

(B) On July 1, 2007, foreign corporation B acquires the assets of foreign corporation C in a reorganization described in section 368(a)(1)(C). Immediately following the foreign section 381 transaction, foreign surviving corporation B is a CFC.

(C) During the 2007 taxable year foreign surviving corporation B has a current deficit of (400u) and $60 of related foreign income taxes. During its short taxable year ending on June 30, 2007, foreign corporation C has no additional earnings and pays or accrues no foreign income taxes.

(ii) *Result.* (A) Under the rules of paragraph (f)(5) of this section, a pro rata amount, in this case 50% or (200u), of foreign surviving corporation B's (400u) current year deficit for the 2007 taxable year will be deemed to have been accumulated prior to the foreign section 381 transaction and be treated as a hovering deficit. The other 50%, or (200u) of the deficit will be deemed to have been accumulated after the foreign section 381 transaction. The related foreign income taxes of $60 will also be allocated on a similar 50/50 basis.

(B) Under the rules described in paragraphs (d)(1) and (2) of this section, foreign surviving corporation B has the following post-1986 undistributed earnings and post-1986 foreign income taxes as of January 1, 2008:

Separate category	Earnings & profits		Foreign taxes	
	E&P	Hovering deficit	Foreign taxes available	Foreign taxes assoicated with hovering deficit
General	(200u)	(300u)	$40	$30

(iii) *Subpart F income limitations.* Even though (200u) of the current year deficit is treated as a hovering deficit, the full (400u) current year deficit in 2007 of foreign surviving corporation B meets the requirements under section 952(c)(1)(C) and therefore is available as a limitation on subpart F income, to the extent foreign corporation A, which wholly owns foreign surviving corporation B, earns any subpart F income in the 2007 taxable year. Any such offset under section 952(c)(1)(C) will have no effect on the earnings and profits and foreign income tax accounts above of foreign surviving corporation B for purposes of sections 316 and 902. Moreover, to the extent the hovering deficit reduces subpart F income under section 952(c)(1)(C), it may not also be taken into account under section 952(c)(1)(B).

(2) *Reconciling taxable years.* If a foreign acquiring corporation and a foreign target corporation had taxable years ending on different dates, then the pro rata distribution rules of paragraphs (e)(1)(ii) and (e)(2)(ii) of this section shall apply with respect to the taxable years that end within the same calendar year.

(3) *Post-transaction change of status.* If a foreign surviving corporation that is subject to the rules of paragraph (c)(2) of this section subsequently becomes a pooling corporation (by reason, for example, of a reorganization, liquidation, or change of ownership), then post-1986 undistributed earnings and post-1986 foreign income taxes that were recharacterized as pre-1987 accumulated profits and pre-1987 foreign income taxes, respectively, under paragraph (e)(2)(i) of this section retain their characterization as a pre-pooling annual layer.

(4) *Ordering rule for multiple hovering deficits*—(i) *Rule.* A foreign surviving corporation shall apply the deficit rules of paragraphs (d)(2), (e)(1)(iii), and (e)(2)(iii) of this section in that order if more than one of such rules applies to the foreign surviving corporation.

(ii) *Example.* The following example illustrates the principles of this paragraph (f)(4). The example assumes the following facts: Foreign corporation A has been a pooling corporation since its incorporation on January 1, 1998. Foreign corporation B has been a nonpooling corporation since its incorporation on January 1, 2000. Foreign corporations A and B have always had calendar taxable years. Foreign corporations A and B (and all of their respective qualified business units as defined in section 989) maintain a ''u'' functional currency. All earnings and profits of foreign corporation B are in the general category. Finally, unless otherwise stated, any earnings and profits in the passive category resulted from a look-through dividend that was paid by a lower-tier CFC out of earnings accumulated when the CFC was a noncontrolled section 902 corporation and that qualified for the subpart F same-country exception under section 954(c)(3)(A). The example is as follows:

Example. (i) *Facts.* (A) On December 31, 2006, foreign corporations A and B have the following earnings and profits and foreign income taxes:

	E&P	Foreign taxes
Foreign Corporation A Post-1986 Pool Separate Category:		
Passive	400u	$160
General	(300u)	25
	100u	185
Foreign Corporation B:		
2006	(300u)	50u
2005	100u	25u
	(200u)	75u

(B) On January 1, 2007, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign section 381 transaction, foreign surviving corporation is a CFC.

(ii) *Result.* Under the rules described in paragraphs (d)(1), (d)(2), (e)(1)(i), (e)(1)(ii), and (e)(1)(iii) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes:

	Earnings & profits		Foreign taxes	
	Positive E&P	Hovering deficit	Foreign taxes availabe	Foreign taxes associated with hovering deficit
Post-1986 pool separate category:				
Passive	400u		$160	

	Earnings & profits		Foreign taxes	
	Positive E&P	Hovering deficit	Foreign taxes availabe	Foreign taxes associated with hovering deficit
General		(300u)		$25
Carryforward pre-pooling deficit from Corp B		(200u)		0
2006 (from Corp B)	0u		50u	
2005 (from Corp B)	0u		25u	
	400u	(500u)		$25

(iii) *Post-transaction earnings.* (A) In the taxable year ending on December 31, 2007, foreign surviving corporation accumulates earnings and profits and pays related foreign income taxes as follows:

	E&P	Foreign taxes
Post-1986 pool separate category:		
Passive	150u	$40
General	400u	60
	550u	100

(B) None of the earnings and profits qualify as subpart F income as defined in section 952(a). Under paragraph (f)(4)(i) of this section, the rules of paragraph (d)(2) of this section apply before the rules of paragraph (e)(1)(iii) of this section. Accordingly, post-transaction earnings in a separate category are first offset by a hovering deficit in the same separate category in the post-1986 pool. Thus, foreign surviving corporation's (300u) deficit in the general category offsets 300u of post-transaction earnings in the general category. After application of paragraph (d)(2) of this section, the (200u) deficit in the general category carried forward from foreign corporation B's pre-pooling aggregate deficit offsets the remaining 100u of post-transaction earnings in the general category. Accordingly, foreign surviving corporation has the following earnings and profits and foreign income taxes at the end of 2007:

	Earnings & profits		Foreign taxes	
	Positive E&P	Hovering deficit	Foreign taxes available	Foreign taxes associated with hovering deficit
Post-1986 pool separate category:				
Passive	550u		$200	
General			$85	
Carryforward pre-pooling deficit from Corp B		(100u)		$0
2006 (from Corp B)	0u		50u	
2005 (from Corp B)	0u		25u	
	550u	(100u)		$0

(C) Under paragraph (d)(2)(iii) of this section, all of the $25 of post-1986 foreign income taxes related to the (300u) hovering deficit in the general category is added to the foreign surviving corporation's post-1986 foreign income taxes of $60 in that category (because post-transaction earnings in the general category have exceeded the deficit in that category). Under paragraph (e)(1)(iii)(C) of this section, the 50u and 25u of foreign income taxes associated with foreign corporation B's pre-1987 accumulated profits for 2006 and 2005 remain in those layers. These foreign income taxes generally will not be reduced or deemed paid unless a foreign tax refund restores a positive balance to the associated earnings pursuant to section 905(c), and thus will be trapped. See § 1.902–2(b)(2).

(5) *Pro rata rule for earnings and deficits during transaction year.* (i) For purposes of offsetting post-transaction earnings of a foreign surviving corporation under the rules described in paragraphs (d)(2), (e)(1)(iii), and (e)(2)(iii) of this section, the earnings and profits, and any related foreign income taxes, in each separate category for the taxable year of the foreign surviving corporation in which the transaction occurs shall be deemed to have been accumulated after such transaction in an amount which bears the same ratio to the undistributed earnings and profits of the foreign surviving corporation for

such taxable year (computed without regard to any earnings and profits carried over) as the number of days in the taxable year after the date of transaction bears to the total number of days in the taxable year. See, e.g., §1.381(c)(2)–1(a)(7) *Example 2* (illustrating application of this rule with respect to domestic corporations).

(ii) For purposes of determining the amount of pre-transaction deficits described in paragraphs (d)(2), (e)(1)(iii), and (e)(2)(iii) of this section, of a foreign surviving corporation that has a deficit in earnings and profits in any separate category for its taxable year in which the transaction occurs, unless the actual accumulated earnings and profits, or deficit, as of such date can be shown, such pre-transaction deficit, and any related foreign income taxes, shall be deemed to have accumulated in a manner similar to that described in paragraph (f)(5)(i) of this section. See, e.g., §1.381(c)(2)–1(a)(7) *Example 4* (illustrating application of this rule with respect to domestic corporations).

(g) *Effective date.* This section shall apply to section 367(b) transactions that occur on or after November 6, 2006.

[T.D. 9273, 71 FR 44985, Aug. 8, 2006; 71 FR 57889, Oct. 2, 2006, as amended at 71 FR 70876, Dec. 7, 2006]

§ 1.367(b)–8 Allocation of earnings and profits and foreign income taxes in certain foreign corporate separations. [Reserved]

§ 1.367(b)–9 Special rule for F reorganizations and similar transactions.

(a) *Scope.* This section applies to a foreign section 381 transaction (as defined in §1.367(b)–7(a)) either—

(1) That is described in section 368(a)(1)(F); or

(2) That involves—

(i) At least one foreign corporation that holds no property and has no tax attributes immediately before the transaction, other than a nominal amount of assets (and related tax attributes) to facilitate its organization or preserve its existence as a corporation; and

(ii) No more than one foreign corporation that holds more than a nominal amount of property or has more than a nominal amount of tax attributes immediately before the transaction.

(b) *Hovering deficit rules inapplicable.* If a transaction is described in paragraph (a) of this section, a foreign surviving corporation shall succeed to earnings and profits, deficits in earnings and profits, and foreign income taxes without regard to the hovering deficit rules of §1.367(b)–7(d)(2), (e)(1)(iii), and (e)(2)(iii).

(c) *Foreign divisive transactions.* [Reserved]

(d) *Examples.* The following examples illustrate the principles of this section:

Example 1. (i) *Facts.* (A) Foreign corporation A is and always has been a wholly owned subsidiary of USP, a domestic corporation. Foreign corporation A was incorporated in 1995, and has always had a calendar taxable year. Foreign corporation A (and all of its respective qualified business units as defined in section 989) maintains a ''u'' functional currency. On December 31, 2006, foreign corporation A has the following post-1986 undistributed earnings and post-1986 foreign income taxes:

Separate Category	E&P	Foreign taxes
Passive	(1,000u)	$5
General	200u	200
	(800u)	205

(B) On January 1, 2007, foreign corporation A moves its place of incorporation from Country 1 to Country 2 in a reorganization described in section 368(a)(1)(F).

(ii) *Result.* Under §1.367(b)–7(d), as modified by paragraph (b) of this section, the pre-transaction deficit of foreign corporation A will not hover. Accordingly, foreign surviving corporation has the following post-1986 undistributed earnings and post-1986 foreign income taxes immediately after the foreign section 381 transaction:

Separate category	E&P	Foreign taxes
Passive	(1,000u)	$5
General	200u	200
	(800u)	205

Example 2. (i) *Facts.* (A) Foreign corporations B, C and D are and always have been wholly owned subsidiaries of USP, a domestic corporation. Foreign corporation B was incorporated in 2000 and foreign corporations C and D were incorporated in 2001. Foreign corporation B does not own any significant property and has no earnings and profits or foreign income taxes accounts. Both foreign

corporations C and D have always had a calendar taxable year. Foreign corporations C and D (and all of their respective qualified business units as defined in section 989) maintain a ''u'' functional currency. On December 31, 2006, foreign corporations C and D have the following post-1986 undistributed earnings and post-1986 foreign income taxes:

	E&P	Foreign taxes
Foreign corporation C Separate Category:		
Passive	(900u)	$50
General	(200u)	100
	(1100u)	150
Foreign corporation D Separate Category:		
Passive	1200u	400
General	400u	100

(B) On January 1, 2007, USP foreign corporations C and D merge into foreign corporation B in a reorganization described in section 368(a)(1)(A).

(ii) *Result.* Although the merger is a foreign section 381 transaction involving a foreign corporation with no property or tax attributes, paragraph (b) of this section does not apply because more than one foreign corporation with significant tax attributes is involved in the foreign section 381 transaction. Accordingly, under § 1.367(b)-7(d), foreign surviving corporation B has the following post-1986 undistributed earnings and post-1986 foreign income taxes immediately after the foreign section 381 transaction:

	E&P	Foreign taxes
	1600u	500

Separate Category	Earnings & profits		Foreign taxes	
	Positive E&P	Hovering deficit	Foreign taxes available	Foreign taxes associated with hovering deficit
General	1200u	(900u)	$400	$50
Passive	400u	(200u)	100	100
	1600u	(1100u)	500	150

(e) *Effective date.* This section shall apply to section 367(b) transactions that occur on or after November 6, 2006.

[T.D. 9273, 71 FR 44913, Aug. 8, 2006]

§ 1.367(b)–10 Acquisition of parent stock or securities for property in triangular reorganizations.

(a) *In general*—(1) *Scope.* Except as provided in paragraphs (a)(2)(i) through (iii) of this section, this section applies to a triangular reorganization if P or S (or both) is a foreign corporation and, in connection with the reorganization, S acquires in exchange for property all or a portion of the P stock or P securities (P acquisition) that are used to acquire the stock, securities or property of T in the triangular reorganization. This section applies to a triangular reorganization regardless of whether P controls (within the meaning of section 368(c)) S at the time of the P acquisition.

(2) *Exceptions.* This section shall not apply if—

(i) P and S are foreign corporations and neither P nor S is a controlled foreign corporation (within the meaning of § 1.367(b)–2(a)) immediately before or immediately after the triangular reorganization;

(ii) S is a domestic corporation, P's stock in S is not a United States real property interest (within the meaning of section 897(c)), and P would not be subject to U.S. tax on a dividend (as determined under section 301(c)(1)) from S under either section 881 (for example, by reason of an applicable treaty) or section 882; or

(iii) In an exchange under section 354 or 356, one or more U.S. persons exchange stock or securities of T and the amount of gain in the T stock or securities recognized by such U.S. persons under section 367(a)(1) is equal to or greater than the sum of the amount of the deemed distribution that would be treated by P as a dividend under section 301(c)(1) and the amount of such deemed distribution that would be treated by P as gain from the sale or exchange of property under section 301(c)(3) if this section would otherwise apply to the triangular reorganization.

See §1.367(a)–3(a)(2)(iv) (providing a similar rule that excludes certain transactions from the application of section 367(a)(1)).

(3) *Definitions.* For purposes of this section, the following definitions apply:

(i) The terms *P*, *S*, and *T* have the meanings set forth in §1.358–6(b)(1)(i), (ii), and (iii), respectively.

(ii) The term *property* has the meaning set forth in section 317(a), except that the term property also includes—

(A) A liability assumed by S to acquire the P stock or securities; and

(B) S stock (or any rights to acquire S stock) to the extent such S stock (or rights to acquire S stock) is used by S to acquire P stock or securities from a person other than P.

(iii) The term *security* means an instrument that constitutes a security for purposes of section 354 or 356.

(iv) The term *triangular reorganization* has the meaning set forth in §1.358–6(b)(2).

(b) *General rules*—(1) *Deemed distribution.* If this section applies, adjustments shall be made that have the effect of a distribution of property (with no built-in gain or loss) from S to P under section 301 (deemed distribution). The amount of the deemed distribution shall equal the sum of the amount of money transferred by S, the amount of any liabilities that are assumed by S and constitute property, and the fair market value of other property transferred by S in the P acquisition in exchange for the P stock or P securities described in paragraph (i) or (ii), respectively, of this paragraph (b)(1)—

(i) P stock received by T shareholders or securityholders in an exchange to which section 354 or 356 applies.

(ii) P securities received by T shareholders or securityholders to the extent such securities are ''other property'' (within the meaning of section 356(d)).

(2) *Deemed contribution.* If this section applies, adjustments shall be made that have the effect of a contribution of property (with no built-in gain or loss) by P to S in an amount equal to the amount of the deemed distribution from S to P under paragraph (b)(1) of this section (deemed contribution).

(3) *Timing of deemed distribution and deemed contribution.* If P controls (within the meaning of section 368(c)) S at the time of the P acquisition, the adjustments described in paragraphs (b)(1) and (2) of this section shall be made as if the deemed distribution and deemed contribution, respectively, are separate transactions occurring immediately before the P acquisition. If P does not control (within the meaning of section 368(c)) S at the time of the P acquisition, the adjustments described in paragraphs (b)(1) and (2) of this section shall be made as if the deemed distribution and deemed contribution, respectively, are separate transactions occurring immediately after P acquires control of S, but prior to the triangular reorganization.

(4) *Application of other provisions.* Nothing in this section shall prevent the application of other provisions of the Internal Revenue Code from applying to the P acquisition. For example, section 304 may apply to the P acquisition. Furthermore, section 1001 or 267 may apply to S's transfer of property to acquire P stock or securities from P or a person other than P. In addition, generally applicable provisions that apply to triangular reorganizations, such as §1.358–6 and §1.1032–2, shall apply to the triangular reorganization in a manner consistent with S acquiring the P stock or securities in exchange for property from P or a person other than P, as the case may be.

(5) *Example.* The rules of this paragraph (b) are illustrated by the following example:

(i) *Facts.* P, a publicly traded domestic corporation, owns all of the outstanding stock of FS, a foreign corporation, and all of the outstanding stock of US1, a domestic corporation that is a member of the P consolidated group. US1 owns all of the outstanding stock of FT, a foreign corporation, the fair market value of which is $100x. US1's basis in the FT stock is $100x, such that there is a no built-in gain or loss in the FT stock. FS has earnings and profits in excess of $100x. FS purchases $100x of P stock from the public on the open market in exchange for $100x of cash. Pursuant to foreign law, FT merges with and into FS in a triangular reorganization that qualifies

under section 368(a)(1)(A) by reason of section 368(a)(2)(D). In an exchange to which section 354 applies, US1 exchanges all the outstanding stock of FT for the $100x of P stock purchased by FS on the open market.

(ii) *Analysis.* The triangular reorganization is described in paragraph (a)(1) of this section. P is a domestic corporation and FS is a foreign corporation. In connection with FS purchasing the $100x of P stock in exchange for property (cash), FS uses the P stock to acquire the FT property in a triangular reorganization, and US1 receives the P stock in an exchange to which section 354 applies. Furthermore, none of the exceptions of paragraphs (a)(2)(i) through (iii) of this section apply. Therefore, pursuant to paragraph (b)(1) of this section, adjustments are made that have the effect of a deemed distribution of property (with no built-in gain or loss) in the amount of $100x from FS to P under section 301. Pursuant to paragraph (b)(2) of this section, adjustments are made that have the effect of a deemed contribution of property (with no built-in gain or loss) in the amount of $100x by P to FS. Pursuant to paragraph (b)(3) of this section, the adjustments described in paragraphs (b)(1) and (2) of this section are made as if the deemed distribution and deemed contribution, respectively, are separate transactions occurring immediately before FS's purchase of the P stock on the open market. Generally applicable provisions apply to FS's purchase of the P stock on the open market (see, for example, section 304) and in determining certain tax consequences to P and FS as a result of the triangular reorganization (see, for example, § 1.358–6(d) and § 1.1032–2(c)).

(c) *Collateral adjustments.* This paragraph (c) provides additional rules that apply by reason of the deemed distribution and deemed contribution described in paragraphs (b)(1) and (b)(2), respectively, of this section.

(1) *Deemed distribution.* A deemed distribution described in paragraph (b)(1) of this section shall be treated as occurring for all purposes of the Internal Revenue Code. Thus, for example, the ordering rules of section 301(c) apply to characterize the deemed distribution to P as a dividend from the earnings and profits of S, return of stock basis, or gain from the sale or exchange of property, as the case may be. Furthermore, sections 902 or 959 may apply to the deemed distribution if S is a foreign corporation, and sections 881, 882, 897, 1442, or 1445 may apply to the deemed distribution if S is a domestic corporation. Appropriate corresponding adjustments shall be made to S's earnings and profits consistent with the principles of section 312.

(2) *Deemed contribution.* A deemed contribution described in paragraph (b)(2) of this section shall be treated as occurring for all purposes of the Internal Revenue Code. Thus, for example, appropriate adjustments shall be made to P's basis in the S stock.

(d) *Anti-abuse rule.* Appropriate adjustments shall be made pursuant to this section if, in connection with a triangular reorganization, a transaction is engaged in with a view to avoid the purpose of this section. For example, if S is created, organized, or funded to avoid the application of this section with respect to the earnings and profits of a corporation related (within the meaning of section 267(b)) to P or S, the earnings and profits of S will be deemed to include the earnings and profits of such related corporation for purposes of determining the consequences of the adjustments provided in this section, and appropriate corresponding adjustments will be made to account for the application of this section to the earnings and profits of such related corporation.

(e) *Effective/applicability date.* This section applies to triangular reorganizations occurring on or after May 17, 2011. For triangular reorganizations that occur prior to May 17, 2011, see § 1.367(b)-14T as contained in 26 CFR part 1 revised as of April 1, 2011.

[T.D. 9526, 76 FR 28893, May 19, 2011]

§ 1.367(b)–12 Subsequent treatment of amounts attributed or included in income.

(a) *In general.* This section applies to distributions with respect to, or a disposition of, stock—

(1) To which, in connection with an exchange occurring before February 23, 2000, an amount has been attributed pursuant to § 7.367(b)–9 or 7.367(b)–10 of

this chapter (as in effect prior to February 23, 2000, see 26 CFR part 1 revised as of April 1, 1999); or

(2) In respect of which, before February 23, 2000, an amount has been included in income or added to earnings and profits pursuant to §7.367(b)–7 or §7.367(b)–10 of this chapter (as in effect prior to February 23, 2000, see 26 CFR part 1 revised as of April 1, 1999).

(b) *Applicable rules.* See §7.367(b)–12(b) through (e) of this chapter (as in effect prior to January 11, 2001, see 26 CFR part 1 revised as of April 1, 2000) for purposes of applying paragraph (a) of this section.

(c) *Effective date.* This section applies to distributions or dispositions that occur on or after January 11, 2001.

[T.D. 8937, 66 FR 2257, Jan. 11, 2001]

§1.367(b)–13 Special rules for determining basis and holding period.

(a) *Scope and definitions*—(1) *Scope.* This section provides special basis and holding period rules to determine the basis and holding period of stock of certain foreign surviving corporations held by a controlling corporation whose stock is issued in an exchange under section 354 or 356 in a triangular reorganization. This section applies to transactions that are subject to section 367(b) as well as section 367(a), including transactions concurrently subject to sections 367(a) and (b).

(2) *Definitions.* For purposes of this section, the following definitions apply:

(i) A block of stock has the meaning provided in §1.1248–2(b).

(ii) The terms *P*, *S*, and *T* have the meanings set forth in §1.358–6(b)(1)(i), (ii), and (iii), respectively.

(iii) A triangular reorganization is a reorganization described in §1.358–6(b)(2)(i), (ii), or (iii), or (v) (a forward triangular merger, triangular C reorganization, reverse triangular merger, or triangular G reorganization, respectively).

(b) *Determination of basis for exchanges of foreign stock or securities under section 354 or 356.* For rules determining the basis of stock or securities in a foreign corporation received in a section 354 or 356 exchange, see §1.358–2.

(c) *Determination of basis and holding period for triangular reorganizations*—(1) *Application.* In the case of a triangular reorganization described in paragraph (a)(2)(ii) of this section, this paragraph (c) applies, if—

(i)(A) Immediately before the transaction, either P is a section 1248 shareholder with respect to S, or P is a foreign corporation and a United States person is a section 1248 shareholder with respect to both P and S; and

(B) In the case of a reverse triangular merger, P's exchange of S stock is not described in §1.367(b)–3(a) and (b) or in §1.367(b)–4(b)(1)(i), (2)(i), or (3); or

(ii)(A) Immediately before the transaction, a shareholder of T is a section 1248 shareholder with respect to T, or a shareholder of T is a foreign corporation and a United States person is a section 1248 shareholder with respect to both such foreign corporation and T; and

(B) With respect to at least one of the exchanging shareholders described in paragraph (c)(1)(ii)(A) of this section, the exchange of T stock is not described in §1.367(b)–3(a) and (b) or in §1.367(b)–4(b)(1)(i), (2)(i), or (3).

(2) *Basis and holding period rules.* In the case of a triangular reorganization described in paragraph (c)(1) of this section, each share of stock of the surviving corporation (S or T) held by P must be divided into portions attributable to the S stock and the T stock immediately before the exchange. See paragraph (e) of this section *Examples 1* through *4* for illustrations of this rule.

(i) *Portions attributable to S stock*—(A) In the case of a forward triangular merger, a triangular C reorganization, or a triangular G reorganization, the basis and holding period of the portion of each share of surviving corporation stock attributable to the S stock is the basis and holding period of such share of stock immediately before the exchange.

(B) In the case of a reverse triangular merger, the basis and holding period of the portion of each share of surviving corporation stock attributable to the S stock is the basis and the holding period immediately before the exchange of a proportionate amount of the S stock to which the portion relates. If P is a shareholder described in paragraph (c)(1)(i)(A) of this section with respect to S, and P exchanges two or more

blocks of S stock pursuant to the transaction, then each share of the surviving corporation (T) attributable to the S stock must be further divided into separate portions to account for the separate blocks of stock in S.

(C) If the value of S stock immediately before the triangular reorganization is less than one percent of the value of the surviving corporation stock immediately after the triangular reorganization, then P may determine its basis in the surviving corporation stock by applying the rules of paragraph (c)(2)(ii) of this section to determine the basis and holding period of the surviving corporation stock attributable to the T stock, and then increasing the basis of each share of surviving corporation stock by the proportionate amount of P's aggregate basis in the S stock immediately before the exchange (without dividing the stock of the surviving corporation into separate portions attributable to the S stock).

(ii) *Portions attributable to T stock*—(A) If any exchanging shareholder of T stock is described in paragraph (c)(1)(ii) of this section, the basis and holding period of the portion of each share of stock in the surviving corporation attributable to the T stock is the basis and holding period immediately before the exchange of a proportionate amount of the T stock to which such portion relates. If any exchanging shareholder of T stock is described in paragraph (c)(1)(ii) of this section, and such shareholder exchanges two or more blocks of T stock pursuant to the transaction, then each share of surviving corporation stock attributable to the T stock must be further divided into separate portions to account for the separate blocks of T stock.

(B) If no exchanging shareholder of T stock is described in paragraph (c)(1)(ii) of this section, the rules of §1.358–6 apply to determine the basis of the portion of each share of the surviving corporation attributable to T immediately before the exchange.

(d) *Special rules applicable to divided shares of stock*—(1) *In general*—(i) Shares of stock in different blocks are aggregated into one divided portion for basis purposes, if such shares immediately before the exchange are owned by one or more shareholders that are—

(A) Not section 1248 shareholders with respect to the corporation; or

(B) Foreign corporate shareholders, provided that no United States persons are section 1248 shareholders with respect to both such foreign corporate shareholders and the corporation.

(ii) For purposes of determining the amount of gain realized on the sale or exchange of stock that has a divided portion pursuant to paragraph (c) of this section, any amount realized on such sale or exchange will be allocated to each divided portion of the stock based on the relative fair market value of the stock to which the portion is attributable at the time the portions were created. See paragraph (e) *Example 5* of this section.

(iii) Shares of stock will no longer be required to be divided if section 1248 or section 964(e) would not apply to a disposition or exchange of such stock.

(2) *Pre-exchange earnings and profits.* All earnings and profits (or deficits) accumulated by a foreign corporation before the reorganization and attributable to a share (or block) of stock for purposes of section 1248 are attributable to the divided portion of stock with the basis and holding period of that share (or block). See §1.367(b)–4(d).

(3) *Post-exchange earnings and profits.* Any earnings and profits (or deficits) accumulated by the surviving corporation subsequent to the reorganization are attributed to each divided share of stock pursuant to section 1248 and the regulations thereunder. The amount of earnings and profits (or deficits) attributable to a divided share of stock is further attributed to the divided portions of such share of stock based on the relative fair market value of each divided portion of stock. See paragraph (e) *Example 5* of this section.

(e) *Examples.* The rules of this section are illustrated by the following examples:

Example 1. Blocks of stock exchanged in a triangular reorganization. (i) *Facts.* (A) US1, a domestic corporation, owns all the stock of F1, a foreign corporation. F1 owns all the stock of FT, a foreign corporation, with 100 shares of stock outstanding. Each share of FT stock is valued at $10x. Because F1 acquired the stock of FT at two different dates, F1 owns two blocks of FT stock for purposes

of section 1248. The first block consists of 60 shares. The shares in the first block have a basis of $300x ($5x per share), a holding period of 10 years, and $240x ($4x per share) of earnings and profits attributable to the shares for purposes of section 1248. The second block consists of 40 shares. The shares in the second block have a basis of $600x ($15x per share), a holding period of 2 years, and $80x ($2x per share) of earnings and profits attributable to the shares for purposes of section 1248.

(B) US2, a domestic corporation, owns all of the stock of FP, a foreign corporation, which owns all of the stock of FS, a foreign corporation. FP owns two blocks of FS stock. Each block consists of 10 shares with a value of $200x ($20x per share). The shares in the first block have a basis of $50x ($5x per share), a holding period of 10 years, and $50x ($5x per share) of earnings and profits attributable to such shares for purposes of section 1248. The shares in the second block had a basis of $100x ($10x per share), a holding period of 5 years, and $20x ($2x per share) of earnings and profits attributable to such shares for purposes of section 1248.

(C) FT merges into FS, with FS surviving, and F1 receives 50 shares of FP stock with a value of $1,000x in exchange for its FT stock. The merger of FT into FS qualifies as forward triangular merger, and immediately after the exchange US1 is a section 1248 shareholder with respect to F1, the exchanging shareholder, FP and FS, all of which are controlled foreign corporations.

(ii) *Basis and holding period determination.* (*1*) US1 is a section 1248 shareholder of F1, the exchanging shareholder, and FT (both of which are controlled foreign corporations) immediately before the transaction. Moreover, F1 is not required to include amounts in income under §1.367(b)–3(b) or 1.367(b)–4(b) as described in paragraph (c)(1)(ii)(B) of this section. Accordingly, the basis and holding period of the FS stock held by FP immediately after the triangular reorganization is determined pursuant to paragraph (c) of this section.

(*2*) Pursuant to paragraph (c) of this section, each share of FS stock is divided into portions attributable to the basis and holding period of the FS stock held by FP immediately before the exchange (the FS portion) and the FT stock held by F1 immediately before the exchange (the FT portion). The basis and holding period of the FS portion is the basis and holding period of the FS stock held by FP immediately before the exchange. Thus, each share of FS stock in the first block has a portion with a basis of $5x, a value of $20x, a holding period of 10 years, and $5x of earnings and profits attributable to such portion for purposes of section 1248. Each share of FS stock in the second block has a portion with a basis of $10x, a value of $20x, a holding period of 5 years, and $2x of earnings and profits attributable to such portion for purposes of section 1248.

(*3*) Because the exchanging shareholder of FT stock (F1) has a section 1248 shareholder (US1), the holding period and basis of the FT portion is the holding period and the proportionate amount of the basis of the FT stock immediately before the exchange to which such portion relates. Further, because F1 exchanged two blocks of FT stock, the FT portion must be divided into two separate portions attributable to the two blocks of FT stock. Thus, each share of FS stock will have a second portion with a basis of $15x ($300x basis / 20 shares), a value of $30x ($600x value / 20 shares), a holding period of 10 years, and $12x of earnings and profits ($240x / 20 shares) attributable to such portion for purposes of section 1248. Each share of FS stock will have a third portion with a basis of $30x ($600x basis / 20 shares), a value of $20x ($400x value / 20 shares), a holding period of 2 years, and $4x of earnings and profits ($80x / 20 shares) attributable to such portion for purposes of section 1248.

(iii) *Subsequent disposition—first block.* Assume, immediately after the transaction, FP disposes of a share of FS stock from the first block. When FP disposes of any share of its FS stock, it is treated as disposing of each divided portion of such share. With respect to the first portion (attributable to the FS stock), FP recognizes a gain of $15x ($20x value − $5x basis), $5x of which is treated as a dividend under section 1248. With respect to the second portion (attributable to the first block of FT stock), FP recognizes a gain of $15x ($30x value − $15x basis), $12x of which is treated as a dividend under section 1248. With respect to the third portion (attributable to the second block of FT stock), FP recognizes a capital loss of $10x ($20x value − $30x basis).

(iv) *Subsequent disposition—second block.* Assume further, immediately after the transaction, FP also disposes of a share of stock from the second block of FS stock. With respect to the first portion (attributable to the FS stock), FP recognizes a gain of $10x ($20x value − $10x basis), $2x of which is treated as a dividend under section 1248. With respect to the second portion (attributable to the first block of FT stock), FP recognizes a gain of $15x ($30x value − $15x basis), $12x of which is treated as a dividend under section 1248. With respect to the third portion (attributable to the second block of FT stock), FP recognizes a capital loss of $10x ($20x value − $30x basis).

Example 2. (i) *Facts.* The facts are the same as in *Example 1*, except that FS merges into FT with FT surviving in a reverse triangular merger. Pursuant to the merger, F1 receives FP stock with a value of $1,000x in exchange for its FT stock, and FP receives 10 shares of FT stock with a value of $1,000x in exchange

for its FS stock. Immediately after the exchange, US1 is a section 1248 shareholder with respect to F1, the exchanging shareholder, FP, and FT, all of which are controlled foreign corporations.

(ii) *Basis and holding period determination*—(A) The basis and holding period of the stock of the surviving corporation held by FP are the same as in *Example 1*, except that each share of the surviving corporation (FT, instead of FS) will be divided into four portions instead of three portions. Because FP exchanges two blocks of FS stock, the FS portion must be divided into two separate portions attributable to the two blocks of FS stock. Because F1 exchanges two blocks of FT stock, the FT portion must be divided into two separate portions attributable to the two blocks of FT stock.

(B) Thus, each share of the surviving corporation (FT) will have a first portion (attributable to the first block of FS stock) with a basis of $5x ($50x / 10 shares), a value of $20x ($200x / 10 shares), a holding period of 10 years, and $5x of earnings and profits ($50x / 10 shares) attributable to such portion for purposes of section 1248. Each share of FT stock will have a second portion (attributable to the second block of FS stock) with a basis of $10x ($100x / 10 shares), a value of $20x ($200x / 10 shares), a holding period of 5 years, and $2x of earnings and profits ($20x / 10 shares) attributable to such portion for purposes of section 1248. Moreover, each share of FT stock will have a third portion (attributable to the first block of FT stock) with a basis of $30x ($300x basis / 10 shares), a value of $60x ($600x value / 10 shares), a holding period of 10 years, and $24x of earnings and profits ($240x / 10 shares) attributable to such portion for purposes of section 1248. Lastly, each share of FT stock will have a fourth portion (attributable to the second block of FT stock) with a basis of $60x ($600x basis / 10 shares), a value of $40x ($400x value / 10 shares), a holding period of 2 years, and $8x of earnings and profits ($80x / 10 shares) attributable to such portion for purposes of section 1248.

Example 3. (i) *Facts.* USP, a domestic corporation, owns all the stock of FS, a foreign corporation with 10 shares of stock outstanding. Each share of FS stock has a value of $10x, a basis of $5x, a holding period of 10 years, and $7x of earnings and profits attributable to such share for purposes of section 1248. FP, a foreign corporation, owns the stock of FT, another foreign corporation. FP and FT do not have any section 1248 shareholders. FT has assets with a value of $100x, a basis of $50x, and no liabilities. The FT stock held by FP has a value of $100x and a basis of $75x. FT merges into FS with FS surviving in a forward triangular merger. Pursuant to the reorganization, FP receives USP stock with a value of $100x in exchange for its FT stock.

(ii) *Basis and holding period determination*—(A) Because USP is a section 1248 shareholder of FS immediately before the transaction, the basis and holding period of the FS stock held by USP immediately after the triangular reorganization is determined pursuant to paragraph (c) of this section.

(B) Pursuant to paragraph (c) of this section, each share of FS stock is divided into portions attributable to the basis and holding period of the FS stock held by USP immediately before the exchange (the FS portion) and the FT portion immediately before the exchange. Because FT does not have a section 1248 shareholder immediately before the transaction, the rules of §1.358–6 apply to determine the basis of the FT portion of each share of FS stock. Those rules determine the basis of FS stock held by USP by reference to the basis of FT's net assets. The basis and holding period of the FS portion is the basis and holding period of the FS stock held by USP immediately before the exchange. Thus, each share of FS stock has a portion with a basis of $5x, a value of $10x, a holding period of 10 years, and $7x of earnings and profits attributable to such portion for section 1248 purposes. The basis of the FT portion is the basis of the FT assets to which such portion relates. Thus, each share of FS stock has a second portion with a basis of $5x ($50x basis in FT's assets / 10 shares) and a value of $10x ($100x value of FT's assets / 10 shares). All of FS's earnings and profits prior to the transaction ($70x) is attributed solely to the FS portion in each share of FS stock. As a result of each share of stock being divided into portions, the basis of the FS stock is not averaged with the basis of the FT assets to increase the section 1248 amount with respect to the stock of the surviving corporation (FS).

Example 4. (i) *Facts.* US, a domestic corporation, owns all of the stock of FT, a foreign corporation. The FT stock held by US constitutes a single block of stock with a value of $1,000x, a basis of $600x, and holding period of 5 years. USP, a domestic corporation, forms FS, a foreign corporation, pursuant to the plan of reorganization and capitalizes it with $10x of cash. FS merges into FT with FT surviving in a reverse triangular merger and a reorganization described in section 368(a)(1)(B). Pursuant to the reorganization, US receives USP stock with a value of $1,000x in exchange for its FT stock, and USP receives 10 shares of FT stock with a value of $1,010x in exchange for its FS stock.

(ii) *Basis and holding period determination.* (A) US and USP are section 1248 shareholders of FT and FS, respectively, immediately before the transaction. Neither US nor USP is required to include amounts in income under §1.367(b)–3(b) or 1.367(b)–4(b) as described in paragraph (c)(1)(i)(B) or (c)(1)(ii)(B) of this section. The basis and holding period of the

FT stock held by USP is determined pursuant to paragraph (c) of this section.

(B) Pursuant to paragraph (c) of this section, because the exchanging shareholder of FT stock (US) is a section 1248 shareholder of FT, each share of the surviving corporation (FT) has a proportionate amount of the basis and holding period of the FT stock immediately before the exchange to which such share relates. Thus, the portion of each share of FT stock attributable to the FT stock has a basis of $60x ($600x basis / 10 shares), a value of $100x ($1,000x value / 10 shares), and a holding period of 5 years. Because the value of FS stock immediately before the triangular reorganization ($10x) is less than one percent of the value of the surviving corporation (FT) immediately after the triangular reorganization ($1,010x), USP may determine its basis in the stock of the surviving corporation (FT) attributable to its FS stock basis held prior to the reorganization by increasing the basis of each share of FT stock by the proportionate amount of USP's aggregate basis in the FS stock immediately before the exchange (without dividing each share of FT stock into separate portions to account for FS and FT). If USP so elects, USP's basis in each share of FT stock is increased by $1x ($10x basis in FS stock / 10 shares). As a result, each share of FT stock has a basis of $61x, a value of $101x, and a holding period of 5 years.

Example 5. (i) *Facts.* US, a domestic corporation, owns all of the stock of F1, a foreign corporation, which owns all the stock of FT, a foreign corporation. The FT stock held by F1 constitutes one block of stock with a basis of $170x, a value of $200x, a holding period of 5 years, and $10x of earnings and profits attributable to such stock for purposes of section 1248. FP, a foreign corporation, owns all the stock of FS, a foreign corporation. FS has 10 shares of stock outstanding. No United States person is a section 1248 shareholder with respect to FP or FS. The FS stock held by FP has a value of $100x and a basis of $50x ($5x per share). FT merges into FS with FS surviving in a forward triangular merger. Pursuant to the merger, F1 receives FP stock with a value of $200x for its FT stock in an exchange that qualifies for nonrecognition under section 354. US is a section 1248 shareholder with respect to F1, the exchanging shareholder, FP, and FS (all of which are controlled foreign corporations) immediately after the exchange.

(ii) *Basis and holding period determination.* (A) Because US is a section 1248 shareholder of F1, the exchanging shareholder, and FT immediately before the transaction, and US is a section 1248 shareholder of F1, FP, and FS immediately after the transactions, F1 is not required to include amounts in income under §§1.367(b)–3(b) and 1.367(b)–4(b) as described in paragraph (c)(1)(ii)(B) of this section. Thus, the basis and holding period of the FS stock held by FP immediately after the triangular reorganization is determined pursuant to paragraph (c) of this section.

(B) Pursuant to paragraph (c) of this section, each share of FS stock is divided into portions attributable to the basis and holding period of the FS stock held by FP immediately before the exchange (the FS portion) and the FT stock held by F1 immediately before the exchange (the FT portion). The basis and holding period of the FS portion is the basis and holding period of the FS stock held by FP immediately before the exchange. Thus, each share of FS stock has a portion with a basis of $5x and a value of $10x. Because the exchanging shareholder of FT stock (F1) has a section 1248 shareholder of both F1 and FT, the basis and holding period of the FT portion is the proportionate amount of the basis and the holding period of the FT stock immediately before the exchange to which such portion relates. Thus, each share of FS stock will have a second portion with a basis of $17x ($170x basis / 10 shares), a value of $20x ($200x value / 10 shares), a holding period of 5 years, and $1x of earnings and profits ($10x earnings and profits / 10 shares) attributable to such portion for purposes of section 1248.

(iii) *Subsequent disposition.* (A) Several years after the merger, FP disposes of all of its FS stock in a transaction governed by section 964(e). At the time of the disposition, FS stock has decreased in value to $210x (a post-merger reduction in value of $90x), and FS has incurred a post-merger deficit in earnings and profits of $30x.

(B) Pursuant to paragraph (d)(1)(ii) of this section, for purposes of determining the amount of gain realized on the sale or exchange of stock that has a divided portion, any amount realized on such sale or exchange is allocated to each divided portion of the stock based on the relative fair market value of the stock to which the portion is attributable at the time the portions were created. Immediately before the merger, the value of the FS stock in relation to the value of both the FS stock and the FT stock was one-third ($100x / ($100x plus $200x)). Likewise, immediately before the merger, the value of the FT stock in relation to the value of both the FT stock and the FS stock was two-thirds ($200x / $100x plus $200x). Accordingly, one-third of the $210x amount realized is allocated to the FS portion of each share and two-thirds to the FT portion of each share. Thus, the amount realized allocated to the FS portion of each share is $7x (one-third of $210x divided by 10 shares). The amount realized allocated to the FT portion of each share is $14x (two-thirds of $210x divided by 10 shares).

(C) Pursuant to paragraph (d)(3) of this section, any earnings and profits (or deficits) accumulated by the surviving corporation

subsequent to the reorganization are attributed to the divided portions of shares of stock based on the relative fair market value of each divided portion of stock. Accordingly, one-third of the post-merger earnings and profits deficit of $30x is allocated to the FS portion of each share and two-thirds to the FT portion of each share. Thus, the deficit in earnings and profits allocated to the FS portion of each share is $1x (one-third of $30x divided by 10 shares). The deficit in earnings and profits allocated to the FT portion of each share is $2x (two-thirds of $30x divided by 10 shares).

(D) When FP disposes of its FS stock, FP is treated as disposing of each divided portion of a share of stock. With respect to the FS portion of each share of stock, FP recognizes a gain of $2x ($7x value − $5x basis), which is not recharacterized as a dividend because a deficit in earnings and profits of $1x is attributable to such portion for purposes of section 1248. With respect to the FT portion of each share of stock, FP recognizes a loss of $3x ($14x value − $17x basis).

(f) *Effective date.* This section applies to exchanges occurring on or after January 23, 2006.

[T.D. 9243, 71 FR 4289, Jan. 26, 2006, as amended by T.D. 9400, 73 FR 30303, May 27, 2008; T.D. 9446, 74 FR 6958, Feb. 11, 2009]

§ 1.367(d)–1T Transfers of intangible property to foreign corporations (temporary).

(a) *Purpose and scope.* This section provides rules under section 367(d) concerning transfers of intangible property by U.S. persons to foreign corporations pursuant to section 351 or 361. Paragraph (b) of this section specifies the transfers that are subject to section 367(d) and the rules of this section, while paragraph (c) provides rules concerning the consequences of such a transfer. In general, the U.S. transferor will be treated as receiving annual payments contingent on productivity or use of the transferred property, over the useful life of the property (regardless of whether such payments are in fact made by the transferee). Paragraphs (d), (e), and (f) of this section provide rules for cases in which there is a later direct or indirect disposition of the intangible property transferred. In general, deemed annual license payments will continue if a transfer is made to a related person, while gain must be recognized immediately if the transfer is to an unrelated person. Paragraph (g) of this section provides several special rules, including a rule allowing appropriate adjustments where deemed payments under section 367(d) are not in fact received by the U.S. transferor of the intangible property, and a rule providing for a limited election to treat certain transfers of intangible property as sales at fair market value (in lieu of applying the general useful life-contingent payment rule). In addition, paragraph (g) of this section provides rules coordinating the application of section 367(d) with other relevant Code sections. Paragraph (h) of this section defines the term *related person* for purposes of this section. Finally, paragraph (i) of this section provides the effective date of this section. For rules concerning transfers of intangible property pursuant to section 332, see §1.367(a)–5T(e). For purposes of determining whether a U.S. person has made a transfer of intangible property that is subject to the rules of section 367(d), the rules of §1.367(a)–1T(c) shall apply.

(b) *Intangible property subject to section 367(d).* Section 367(d) and the rules of this section shall apply to the transfer of any intangible property, as defined in §1.367(a)–1T(d)(5)(i). However, section 367(d) and the rules of this section shall not apply to the transfer of foreign goodwill or going concern value, as defined in §1.367(a)–1T(d)(5)(iii), or to the transfer of intangible property described in §1.367(a)–5T(b)(2). However, the transfer of those items to a foreign corporation is subject to the rules set forth in §1.367(a)–6T, and the transfer of intangible property described in §1.367(a)–5T(b)(2) is subject to the rules set forth in §1.367(a)–5T. For a special rule relating to the transfer of operating intangibles, as defined in §1.367(a)–1T(d)(5)(ii), see paragraph (g)(3) of this section. Transfers of intangible property to foreign corporations pursuant to section 351 or 361 are subject to the rules of this section regardless of whether the property is to be used in the United States, in connection with goods to be sold or consumed in the United States, or in connection with a trade or business outside the United States.

(c) *Deemed payments upon transfer of intangible property to foreign corporation*—(1) *In general.* If a U.S. person transfers intangible property that is subject to section 367(d) and the rules of this section to a foreign corporation in an exchange described in section 351 or 361, then such person shall be treated as having transferred that property in exchange for annual payments contingent on the productivity or use of the property. Such person shall, over the useful life of the property, annually include in gross income an amount that represents an appropriate arms-length charge for the use of the property. The appropriate charge shall be determined in accordance with the provisions of section 482 and regulations thereunder. See §1.482–2(d). The amount of the deemed payment thus calculated shall be reduced by any royalty or other periodic payment made or accrued by the transferee to an unrelated person during that taxable year for the right to use the intangible property. Amounts so included in the transferor's income shall be treated as ordinary income from sources within the United States. For purposes of computing estimated tax payments, deemed payments under this paragraph (c) shall be treated as received by the transferor on the last day of its taxable year.

(2) *Required adjustments.* The following adjustments shall be made with respect to a U.S. person's recognition of a deemed payment for the use of intangible property under this paragraph (c):

(i) For purposes of chapter 1 of the Code, the earnings and profits of the transferee foreign corporation shall be reduced by the amount of such deemed payment; and

(ii) For purposes of subpart F of part III of subchapter N of the Code, the transferee foreign corporation may treat such deemed payment as an expense (whether or not that amount is actually paid), properly allocated and apportioned to gross income subject to subpart F, in accordance with the provisions of §§1.954–1(c) and 1.861–8.

No other special adjustments to earning the profits, basis, or gross income shall be permitted by reason of the recognition of a deemed payment under this paragraph (c). However, see paragraph (g)(1) of this section for rules permitting the establishment of an account receivable with respect to deemed payments not actually received by the U.S. person.

(3) *Useful life.* For purposes of this section, the useful life of intangible property is the entire period during which the property has value. However, in no event shall the useful life of an item of intangible property be considered to exceed twenty years. If intangible property derives its value from secrecy or from protections afforded by law, the useful life of such property shall terminate when the property is no longer secret or no longer legally protected.

(4) *Blocked income.* No deemed payment included in a taxpayer's income under paragraph (c)(1) of this section shall be treated as deferrable income for purposes of applying rules relating to blocked foreign income. See Revenue Ruling 74–351, 1974–2 C.B. 144.

(d) *Subsequent transfer of stock of transferee foreign corporation to unrelated person*—(1) *Treatment as sale of intangible property.* If a U.S. person transfers intangible property that is subject to section 367(d) and the rules of this section to a foreign corporation in an exchange described in section 351 or 361, and within the useful life of the intangible property that U.S. transferor subsequently disposes of the stock of the transferee foreign corporation to a person that is not a related person (within the meaning of paragraph (h) of this section), then the U.S. transferor shall be treated as having simultaneously sold the intangible property to the person acquiring the stock of the transferee foreign corporation. The U.S. transferor shall be required to recognize gain (but not loss) from sources within the United States in an amount equal to the difference between the fair market value of the transferred intangible property on the date of the subsequent disposition and the U.S. transferor's former adjusted basis in that property (determined as of the original transfer). If the U.S. transferor's disposition of the stock of the transferee foreign corporation is subject to U.S.

tax other than by reason of this paragraph (d), then the amount of gain otherwise required to be recognized with respect to the stock of the transferee foreign corporation shall be reduced by the amount of gain recognized with respect to the intangible property pursuant to this paragraph (d).

(2) *Required adjustments.* If a U.S. person disposes of the stock of a transferee foreign corporation, and under paragraph (d)(1) of this section is treated as having simultaneously sold intangible property, then, for purposes of computing basis and earnings and profits, the person acquiring the stock of the transferee foreign corporation shall be deemed to have purchased that property at fair market value and to have immediately thereafter contributed it to the transferee foreign corporation in a transaction not covered by section 367(d). Therefore, for purposes of chapter 1 of the Code—

(i) The transferee foreign corporation's basis in the intangible property will be equal to its fair market value (as calculated for purposes of determining the gain required to be recognized by the U.S. transferor);

(ii) The acquiring person's basis in the stock of the transferee foreign corporation shall be determined as if no portion of the consideration given by the acquiring person for the stock is attributable to the intangible property; and

(iii) The earnings and profits of the transferee foreign corporation will not be affected by the transfer of its stock or the deemed transfer to it of the intangible property.

(e) *Subsequent transfer of stock of transferee foreign corporation to related person*—(1) *Transfer to related U.S. person treated as disposition of intangible property.* If a U.S. person transfers intangible property that is subject to section 367(d) and the rules of this section to a foreign corporation in an exchange described in section 351 or 361 and, within the useful life of the transferred intangible property, that U.S. transferor subsequently transfers the stock of the transferee foreign corporation to U.S. persons that are related to the transferor within the meaning of paragraph (h) of this section, then the following rules shall apply:

(i) Each such related U.S. person shall be treated as having received (with the stock of the transferee foreign corporation) a right to receive a proportionate share of the contingent annual payments that would otherwise be deemed to be received by the U.S. transferor under paragraph (c) of this section.

(ii) Each such related U.S. person shall, over the useful life of the property, annually include in gross income a proportionate share of the amount that would have been included in the income of the U.S. transferor pursuant to paragraph (c) of this section. Such amounts shall be treated as ordinary income from sources within the United States.

(iii) The amount of income required to be recognized by the U.S. transferor pursuant to the rule of paragraph (d)(1) of this section shall be reduced to the amount determined in accordance with the following formula:

(d)(1) amount × (100% − (e) percentage)

For purposes of the above formula, the (*d*)(*1*) *amount* is the income that would otherwise be required to be recognized by the transferor corporation pursuant to paragraph (d)(1) of this section, and the (*e*) *percentage* is the percentage of the transferor corporation's total deemed rights to receive contingent annual payments under paragraph (c) of this section that is deemed to be transferred to related U.S. persons under the rules of this paragraph (e).

(iv) The rules of paragraphs (d) and (e) of this section shall be reapplied in the case of any later transfer of the stock of the transferee foreign corporation by a related U.S. person that received such stock in a transfer that was subject to the rules of this paragraph (e). For purposes of reapplying the rules of paragraphs (d) and (e), each such related U.S. person shall be treated as a U.S. transferor of intangible property to the transferee foreign corporation (to the extent of the interest attributed to such person pursuant to subdivision (i) of this paragraph (e)(1)).

(2) *Required adjustments.* If a U.S. person transfers stock of a transferee foreign corporation to a U.S. related person in a transaction that is subject to

the rules of paragraph (e)(1) of this section, the following adjustments shall be made:

(i) For purposes of chapter 1 of the Code, the earnings and profits of the transferee foreign corporation shall be reduced by the amount of any payment deemed to be received by a related U.S. person under paragraph (e)(1)(ii) of this section;

(ii) For purposes of subpart F of part III of subchapter N of the Code, the transferee foreign corporation may allocate and apportion such deemed payments (whether or not such payments are actually made to gross income subject to subpart F to the extent appropriate under the provisions of §§ 1.954–1(c) and 1.861–8;

(iii) For purposes of reapplying the rules of paragraph (d) and (e) of this section, if the related U.S. person is deemed to have received a right to contingent annual payments for the use of intangible property, then the U.S. related person shall be deemed to have held a proportionate share of the property with a basis equal to a proportionate share of the U.S. transferor's adjusted basis plus the gain, if any, recognized by the U.S. transferor on the earlier transfer of the stock to the U.S. related person, and then to have transferred that proportionate share of the property to the foreign corporation in a transfer subject to section 367(d); and

(iv) If the U.S. transferor is itself required to recognize gain upon the transfer by reason of the operation of paragraphs (d)(1) and (e)(1)(iii) of this section (because stock of the transferee foreign corporation is also transferred to unrelated persons), then those unrelated persons shall be deemed to have purchased a proportionate share of the transferred intangible property at fair market value and immediately contributed that property to the transferee foreign corporation, consistent with the general rule of paragraph (d)(2) of this section concerning transfers of stock to unrelated persons. Therefore, for purposes of chapter 1 of the Code—

(A) Each unrelated person's basis in the stock of the transferee foreign corporation shall be increased to the extent of the gain recognized by the U.S. transferor upon the deemed purchase of intangible property by that person; and

(B) The transferee foreign corporation will receive an increase in its basis in the transferred intangible property equal to the fair market value of that portion of the intangible property deemed to be contributed to the transferee foreign corporation by unrelated persons (as calculated for purposes of determining the gain required to be recognized by the U.S. transferor).

(3) *Transfer to related foreign person not treated as disposition of intangible property.* If a U.S. person transfers intangible property that is subject to section 367(d) and the rules of this section to a foreign corporation in an exchange described in section 351 or 361, and within the useful life of the transferred intangible property, that U.S. transferor subsequently transfers any of the stock of the transferee foreign corporation to one or more foreign persons that are related to the transferor within the meaning of paragraph (h) of this section, then the U.S. transferor shall continue to include in its income the deemed payments described in paragraph (c) of this section in the same manner as if the subsequent transfer of stock had not occurred. The rule of this paragraph (e)(3) shall not apply with respect to the subsequent transfer by the U.S. person of any of the remaining stock to any related U.S. person or unrelated person.

(4) *Proportionate share.* For purposes of this paragraph (e), any ''proportionate share'' shall be determined by reference to the fair market value (at the time of the original transfer) of the stock of the transferee foreign corporation that was transferred by the U.S. transferor and the fair market value of all of the stock of the transferee foreign corporation originally received by the U.S. transferor.

(f) *Subsequent disposition of transferred intangible property by transferee foreign corporation*—(1) *In general.* If a U.S. person transfers intangible property that is subject to section 367(d) and the rules of this section to a foreign corporation in an exchange described in section 351 or 361, and within the useful life of the intangible property that

transferee foreign corporation subsequently disposes of the intangible property to an unrelated person, then—

(i) The U.S. transferor of the intangible property (or any person treated as such pursuant to paragraph (e)(1) of this section) shall be required to recognize gain from U.S. sources (but not loss) in an amount equal to the difference between the fair market value of the transferred intangible property on the date of the subsequent disposition and the U.S. transferor's former adjusted basis in that property (determined as of the orginial transfer); and

(ii) The U.S. transferor shall be required to recognize a deemed payment under paragraph (c) of this section for that part of its taxable year that the intangible property was held by the transferee foreign corporation and thereafter shall not be required to recognize any further deemed payments under paragraph (c) or (e)(1) of this section with respect to the transferred intangible property disposed of by the transferee foreign corporation.

(2) *Required adjustments.* If a U.S. transferor is required to recognize gain under paragraph (f)(1) of this section, then—

(i) For purposes of chapter 1 of the Code, the earnings and profits of the transferee foreign corporation shall be reduced by the amount of gain required to be recognized; and

(ii) The U.S. transferor's recognition of gain will permit the establishment of an account receivable from the transferee foreign corporation, in accordance with paragraph (g)(1) of this section.

(3) *Subsequent transfer of intangible property to related person.* The requirement that a U.S. person recognize gain under paragraph (c) or (e) of this section shall not be affected by the transferee foreign corporation's subsequent disposition of the transferred intangible property to a related person. For purposes of any required adjustments, and of any accounts receivable created under paragraph (g)(1) of this section, the related person that receives the intangible property shall be treated as the transferee foreign corporation.

(g) *Special rules*—(1) *Establishment of accounts receivable*—(i) *In general.* If a U.S. person is required to recognize income under the provisions of paragraph (c), (e), or (f) of this section, and the amount deemed to be received is not actually paid by the transferee foreign corporation, then the U.S. person may establish an account receivable from the transferee foreign corporation equal to the amount deemed paid that was not actually paid. A separate account receivable must be established for each taxable year in which payments deemed to be received are not actually made. Payments received from the transferee foreign corporation must be designated as payments upon a particular account and must be deducted from that account. Accounts receivable under this paragraph (g)(1) may be established and paid without further U.S. income tax consequences to the U.S. transferor or the transferee foreign corporation. No interest shall be paid or accrued on an account receivable created under this paragraph (g)(1), nor shall any bad debt deduction be allowed under section 166 with respect to any failure to receive payment on an account.

(ii) *Unpaid receivable treated as contribution to capital.* If any portion of an account receivable established under this paragraph (g)(1) remains unpaid as of the last day of the third taxable year following the taxable year to which the account relates, then—

(A) Such portion shall be deemed to have been paid on that date; and

(B) The U.S. person shall be deemed to have contributed an equivalent amount to the capital of the foreign corporation, and the U.S. person's basis in the stock of the foreign corporation shall, therefore, be increased by that amount.

(2) *Election to treat transfer as sale.* A U.S. person that transfers intangible property to a foreign corporation in a transaction subject to section 367(d) may elect to recognize income in accordance with the rules of this paragraph (g)(2), if—

(i) The intangible property transferred constitutes an operating intangible, as defined in §1.367(a)–1T(d)(5)(ii); or

(ii) The transfer of the intangible property is either legally required by the government of the country in

which the transferee corporation is organized as a condition of doing business in that country, or compelled by a genuine threat of immediate expropriation by the foreign government; or

(iii)(A) The U.S. person transferred the intangible property to the foreign corporation within three months of the organization of that corporation and as part of the original plan of capitalization of that corporation;

(B) Immediately after the transfer, the U.S. person owns at least 40 percent but not more than 60 percent of the total voting power and total value of the stock of the transferee foreign corporation;

(C) Immediately after the transfer, at least 40 percent of the total voting power and total value of the stock of the transferee foreign corporation is owned by foreign persons unrelated to the U.S. person;

(D) Intangible property constitutes at least 50 percent of the fair market value of the property transferred to the foreign corporation by the U.S. transferor; and

(E) The transferred intangible property will be used in the active conduct of a trade or business outside of the United States within the meaning of §1.367(a)–2T and will not be used in connection with the manufacture or sale of products in or for use or consumption in the United States.

A person that makes the election under this paragraph (g)(2) shall not be subject to the provisions of paragraphs (c) through (f) of this section. Such person shall instead recognize in the year of the transfer ordinary income from sources within the United States in an amount equal to the difference between the fair market value of the intangible property transferred and its adjusted basis. A U.S. person shall make an election under this paragraph (g)(2) by notifying the Internal Revenue Service of the election in accordance with the requirements of section 6038B and regulations thereunder, and subsequently including the appropriate amounts in gross income in a timely filed tax return for the year of the transfer.

(3) *Intangible property transferred from branch with previously deducted losses.* If income is required to be recognized under section 904(f)(3) and the regulations thereunder or under §1.367(a)–6T upon the transfer of intangible property of a foreign branch that had previously deducted losses, then the income recognized under those sections with respect to that property shall be credited against amounts that would otherwise be required to be recognized with respect to that same property under paragraphs (c) through (f) of this section in either the current or future taxable years. The amount recognized under section 904(f)(3) or §1.367(a)–6T with respect to the transferred intangible property shall be determined in accordance with the following formula:

$$\text{loss recapture income} \times \frac{\text{gain from intangibles}}{\text{gain from all branch assets}}$$

For purposes of the above formula, the *loss recapture income* is the total amount required to be recognized by the U.S. transferor pursuant to section 904(f)(3) or §1.367(a)–6T. The *gain from intangibles* is the total amount of gain realized by the U.S. transferor pursuant to section 904(f)(3) and §1.367(a)–6T upon the transfer of items of intangible property that are subject to section 367(d). (''Gain from intangibles'' does not include gain realized upon the transfer of property described in §1.367(a)–5T(b)(2), foreign goodwill or going concern value, or intangible property with respect to which the taxpayer has made the election provided for in §1.367(d)–1T(g)(2).) The *gain from all branch assets* is the total amount of gain realized by the transferor upon the transfer of items of property of the branch in which gain is realized. The fraction shall not exceed 1.

(4) *Coordination with section 482*—(i) *In general.* Section 367(d) and the rules of this section shall not apply in the case

of an actual sale or license of intangible property by a U.S. person to a foreign corporation. If an adjustment under section 482 is required with respect to an actual sale or license of intangible property, then section 367(d) and the rules of this section shall not apply with respect to the required adjustment. If a U.S. person transfers intangible property to a related foreign corporation without consideration, or in exchange for stock or securities of the transferee in a transaction described in sections 351 or 361, no sale or license subject to adjustment under section 482 will be deemed to have occurred. Instead, the U.S. person shall be treated as having made a transfer of the intangible property that is subject to section 367(d).

(ii) *Sham licenses and sales.* For purposes of paragraph (g)(4)(i) of this section, a purported sale or license of intangible property may be disregarded, and treated as a transfer subject to section 367(d) and the rules of this section, if—

(A) The purported sale or license is made to a foreign corporation in which the transferor holds (or is acquiring) an interest; and

(B) The terms of the purported sale or license differ so greatly from the economic substance of the transaction or the terms that would obtain between unrelated persons that the purported sale or license is a sham.

The terms of a purported sale or license, for purposes of applying the rule of this paragraph (g)(4)(ii), shall be determined by reference not only to the nominal terms of the agreement but also to the actual practice of the parties under that agreement. A sale or license of intangible property shall not be disregarded under this paragraph (g)(4)(ii) solely because other property of an integrated business is simultaneously transferred to the foreign corporation by the U.S. transferor in a transaction described in section 367(a)(1) or any statutory or regulatory exception to section 367(a)(1).

(5) *Determination of fair market value.* For purposes of determining the gain required to be recognized immediately under paragraph (d), (f), or (g)(2) of this section, the fair market value of transferred property shall be the single payment arm's-length price that would be paid for the property by an unrelated purchaser determined in accordance with the principles of section 482 and regulations thereunder. The allocation of a portion of the purchase price to intangible property agreed to by the parties to the transaction shall not necessarily be controlling for this purpose.

(6) *Anti-abuse rule.* If a U.S. person—

(i) Transfers intangible property to a domestic corporation with a principal purpose of avoiding the effect of section 367(d) and the rules of this section; and

(ii) Thereafter transfers the stock of that domestic corporation to a related foreign corporation,

then solely for purposes of section 367(d) that U.S. person shall be treated as having transferred the intangible property directly to the foreign corporation. A U.S. person shall be presumed to have transferred intangible property for a principal purpose of avoiding the effect of section 367(d) if the property is transferred to the domestic corporation less than two years prior to the transfer of the stock of that domestic corporation to a foreign corporation. The presumption created by the previous sentence may be rebutted by clear evidence that the subsequent transfer of the stock of the domestic transferee corporation was not contemplated at the time the intangible property was transferred to that corporation and that avoidance of section 367(d) and the rules of this section was not a principal purpose of the transaction. A transfer may have more than one principal purpose.

(h) *Related person.* For purposes of this section, persons are considered to be related if—

(1) They are partners or partnerships described in section 707(b)(1) of the Code; or

(2) They are related within the meaning of section 267 (b), (c), and (f) of the Code, except that—

(i) ''10 percent or more'' shall be substituted for ''more than 50 percent'' each place it appears; and

(ii) Section 1563 shall apply (for purposes of section 267(d)), without regard to section 1563(b)(2).

(i) *Effective date.* Except as specifically provided to the contrary elsewhere in this section, this section applies to transfers occurring after December 31, 1984.

[T.D. 8087, 51 FR 17953, May 16, 1986, as amended by T.D. 8770, 63 FR 33568, June 19, 1998]

§ 1.367(e)–0 Outline of §§ 1.367(e)–1 and 1.367(e)–2.

This section lists captioned paragraphs contained in §§1.367(e)–1 and 1.367(e)–2 as follows:

§ 1.367(e)–1 Distributions described in section 367(e)(1).

(a) Purpose and scope.
(b) Gain recognition.
(1) General rule.
(2) Stock owned through partnerships, disregarded entities, trusts, and estates.
(3) Gain computation.
(4) Treatment of distributee.
(c) Nonrecognition of gain.
(d) Determining whether distributees are qualified U.S. persons.
(1) General rule—presumption of foreign status.
(2) Non-publicly traded distributing corporations.
(3) Publicly traded distributing corporations.
(i) Five percent shareholders.
(ii) Other distributees.
(4) Qualified exchange or other market.
(e) Reporting under section 6038B.
(f) Effective date.

§ 1.367(e)–2 Distributions described in section 367(e)(2).

(a) Purpose and scope.
(1) In general.
(2) Nonapplicability of section 367(a).
(b) Distribution by a domestic corporation.
(1) General rule.
(i) Recognition of gain and loss.
(ii) Operating rules.
(A) General rule.
(B) Overall loss limitation.
(*1*) Overall loss limitation rule.
(*2*) Example.
(C) Special rules for built-in gains and losses attributable to property received in liquidations and reorganizations.
(iii) Distribution of partnership interest.
(A) General rule.
(B) Gain or loss calculation. [Reserved]
(C) Basis adjustments.
(D) Publicly traded partnerships.
(2) Exceptions.
(i) Distribution of property used in a U.S. trade or business.
(A) Conditions for nonrecognition.
(B) Qualifying property.
(C) Required statement.
(*1*) Declaration and certification.
(*2*) Property description.
(*3*) Distributee identification.
(*4*) Treaty benefits waiver.
(*5*) Statute of limitations extension.
(D) Failure to file statement.
(E) Operating rules.
(*1*) Gain or loss recognition by the foreign distributee corporation.
(*i*) Taxable dispositions.
(*ii*) Other triggering events.
(*2*) Gain recognition by the domestic liquidating corporation.
(*i*) General rule.
(*ii*) Amended return.
(*iii*) Interest.
(*iv*) Joint and several liability.
(*3*) Schedule for property no longer used in a U.S. trade or business.
(*4*) Nontriggering events.
(*i*) Conversions, certain exchanges, and abandonment.
(*ii*) Amendment to Master Property Description
(*5*) Nontriggering transfers to qualified transferees.
(ii) Distribution of certain U.S. real property interests.
(iii) Distribution of stock of domestic subsidiary corporations.
(A) Conditions for nonrecognition.
(B) Exceptions when the liquidating corporation is a U.S. real property holding corporation.
(C) Anti-abuse rule.
(D) Required statement.
(3) Other consequences.
(i) Distributee basis in property.
(ii) Reporting under section 6038B.
(iii) Other rules.
(c) Distribution by a foreign corporation.
(1) General rule—gain and loss not recognized.
(2) Exceptions.
(i) Property used in a U.S. trade or business.
(A) General rule.
(B) Ten-year active U.S. business exception.
(C) Required statement.
(D) Operating rules.
(ii) Property formerly used in a U.S. trade or business.
(3) Other consequences.
(i) Distributee basis in property.
(ii) Other rules.
(d) Anti-abuse rule.
(e) Effective date.

[T.D. 8834, 64 FR 43075, Aug. 9, 1999]

§ 1.367(e)–1 Distributions described in section 367(e)(1).

(a) *Purpose and scope.* This section provides rules for recognition (and nonrecognition) of gain by a domestic corporation (distributing corporation) on a distribution of stock or securities of a corporation (controlled corporation) to foreign persons that is described in section 355. Paragraph (b) of this section contains the general rule that gain is recognized on the distribution to the extent stock or securities of controlled are distributed to foreign persons. Paragraph (c) of this section provides an exception to the gain recognition rule for distributions of stock or securities of a domestic corporation. Paragraph (d) of this section contains rules for determining whether distributees of stock or securities in a section 355 distribution are qualified U.S. persons. Paragraph (e) of this section provides cross-references. Finally, paragraph (f) of this section specifies the effective date of this section.

(b) *Gain recognition*—(1) *General rule.* If a domestic corporation makes a distribution of stock or securities of a corporation that qualifies for nonrecognition under section 355 to a person who is not a qualified U.S. person, then, except as provided in paragraph (c) of this section, the distributing corporation shall recognize gain (but not loss) on the distribution under section 367(e)(1). A distributing corporation shall not recognize gain under this section with respect to a section 355 distribution to a qualified U.S. person. For purposes of this section, a qualified U.S. person is—

(A) A citizen or resident of the United States; or

(B) A domestic corporation.

(2) *Stock owned through partnerships, disregarded entities, trusts, and estates.* For purposes of this section, distributing corporation stock or securities owned by or for a partnership (whether foreign or domestic) are owned proportionately by its partners. A partner's proportionate share of the stock or securities of the distributing corporation shall be equal to the partner's distributive share of the gain that would have been recognized had the partnership sold the stock or securities (at a taxable gain) immediately before the distribution. The partner's distributive share of gain shall be determined under the rules and principles of sections 701 through 761 and the regulations thereunder. For purposes of this section, stock or securities owned by or for an entity that is disregarded as an entity separate from its owner (disregarded entity) under § 301.7701–3 of this chapter are owned directly by the owner of such disregarded entity. For purposes of this section, stock or securities owned by or for a trust or estate (whether foreign or domestic) are owned proportionately by the persons who would be treated as owning such stock or securities under section 318(a)(2)(A) and (B). In applying section 318(a)(2)(B)(i), if a trust includes interests that are not actuarially ascertainable, all such interests shall be considered to be owned by foreign persons. In a case where an interest holder in a partnership, a disregarded entity, trust, or estate that (directly or indirectly) owns stock of the distributing corporation is itself a partnership, disregarded entity, trust, or estate, the rules of this paragraph (b)(2) apply to such interest holder.

(3) *Gain computation.* Gain recognized under paragraph (b)(1) of this section shall be equal to the excess of the fair market value of the stock or securities distributed to persons who are not qualified U.S. persons (determined as of the time of the distribution) over the distributing corporation's adjusted basis in the stock or securities distributed to such distributees. For purposes of the preceding sentence, the distributing corporation's adjusted basis in each unit of each class of stock or securities distributed to a distributee shall be equal to the distributing corporation's total adjusted basis in all of the units of the respective class of stock or securities owned immediately before the distribution, divided by the total number of units of the class of stock or securities owned immediately before the distribution.

(4) *Treatment of distributee.* If the distribution otherwise qualifies for nonrecognition under section 355, each distributee shall be considered to have received stock or securities in a distribution qualifying for nonrecognition

under section 355, even though the distributing corporation may recognize gain on the distribution under this section. Thus, the distributee shall not be considered to have received a distribution described in section 301 or a distribution in an exchange described in section 302(b) upon the receipt of the stock or securities of the controlled corporation, and the domestic distributing corporation shall have no withholding responsibilities under section 1441. Except where section 897(e)(1) and the regulations thereunder cause gain to be recognized by the distributee, the basis of the distributed domestic or foreign corporation stock in the hands of the foreign distributee shall be the basis of the distributed stock determined under section 358 without any increase for any gain recognized by the domestic corporation on the distribution.

(c) *Nonrecognition of gain.* A domestic distributing corporation shall not recognize gain under paragraph (b)(1) of this section on the distribution of stock or securities of a domestic corporation.

(d) *Determining whether distributees are qualified U.S. persons*—(1) *General rule—presumption of foreign status.* Except as provided in paragraphs (d)(2) and (3) of this section, all distributions of stock or securities in a distribution described in section 355 in which the distributing corporation is domestic and the controlled corporation is foreign are presumed to be to persons who are not qualified U.S. persons, as defined in paragraph (b)(1) of this section.

(2) *Non-publicly traded distributing corporations.* If the class of stock or securities of the distributing corporation (in respect to which stock or securities of the controlled corporation are distributed) is not regularly traded on a qualified exchange or other market (as defined in paragraph (d)(4) of this section), then the distributing corporation may only rebut the presumption contained in paragraph (d)(1) of this section by identifying the qualified U.S. persons to which controlled corporation stock or securities were distributed and by certifying the amount of stock or securities that were distributed to the qualified U.S. persons.

(3) *Publicly traded distributing corporations.* If the class of stock or securities of the distributing corporation (in respect to which stock or securities of the controlled corporation are distributed) is regularly traded on a qualified exchange or other market (as defined in paragraph (d)(4) of this section), then the distributing corporation may only rebut the presumption contained in paragraph (d)(1) of this section as described in this paragraph (d)(3).

(i) *Five percent shareholders.* A publicly traded distributing corporation may only rebut the presumption contained in paragraph (d)(1) of this section with respect to distributees that are five percent shareholders of the class of stock or securities of the distributing corporation (in respect to which stock or securities of the controlled corporation are distributed) by identifying the qualified U.S. persons to which controlled corporation stock or securities were distributed and by certifying the amount of stock or securities that were distributed to the qualified U.S. persons. A five percent shareholder is a distributee who is required under U.S. securities laws to file with the Securities and Exchange Commission (SEC) a Schedule 13D or 13G under 17 CFR 240.13d-1 or 17 CFR 240.13d-2, and provide a copy of same to the distributing corporation under 17 CFR 240.13d-7.

(ii) *Other distributees.* A distributing corporation that has made a distribution described in paragraph (d)(3) of this section may rebut the presumption contained in paragraph (d)(1) of this section with respect to distributees that are not five percent shareholders (as defined in this paragraph (d)(3)) by relying on and providing a reasonable analysis of shareholder records and other relevant information that demonstrates a number of distributees that are qualified U.S. persons. Taxpayers may rely on such analysis, unless it is subsequently determined that there are actually fewer distributees who are qualified U.S. persons than were demonstrated in the analysis.

(4) *Qualified exchange or other market.* For purposes of paragraph (d) of this section, the term qualified exchange or

other market means, for any taxable year—

(i) A national securities exchange which is registered with the SEC or the national market system established pursuant to section 11A of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(ii) A foreign securities exchange that is regulated or supervised by a governmental authority of the country in which the market is located and which has the following characteristics—

(A) The exchange has trading volume, listing, financial disclosure, and other requirements designed to prevent fraudulent and manipulative acts and practices, to remove impediments to and perfect the mechanism of a free and open market, and to protect investors; and the laws of the country in which the exchange is located and the rules of the exchange ensure that such requirements are actually enforced; and

(B) The rules of the exchange ensure active trading of listed stocks.

(e) *Cross-references.* For additional rules relating to the distribution of the stock of a foreign corporation by a domestic corporation, see §§1.367(a)–3(e), 1.367(a)–7, 1.367(b)–5, and 1.1248(f)–1 through 1.1248(f)–3. See the regulations under section 6038B for reporting requirements for distributions under this section.

(f) *Effective/applicability date.* This section shall be applicable to distributions occurring in taxable years ending after August 8, 1999.

[T.D. 8834, 64 FR 43076, Aug. 9, 1999; 65 FR 14467, Mar. 3, 2000, as amended by T.D. 9614, 78 FR 17041, Mar. 19, 2013; T.D. 9760, 81 FR 15169, Mar. 22, 2016]

§ 1.367(e)–2 Distributions described in section 367(e)(2).

(a) *Purpose and scope*—(1) *In general.* This section provides rules requiring gain and loss recognition by a corporation on its distribution of property to a foreign corporation in a complete liquidation described in section 332. Paragraph (b)(1) of this section contains the general rule that gain and loss are recognized when a domestic corporation makes a distribution of property in complete liquidation under section 332 to a foreign corporation that meets the stock ownership requirements of section 332(b) with respect to stock in the domestic corporation. Paragraph (b)(2) of this section provides the only exceptions to the gain and loss recognition rule of paragraph (b)(1) of this section. Paragraph (b)(3) of this section refers to other consequences of distributions described in paragraphs (b)(1) and (2) of this section. Paragraph (c)(1) of this section contains the general rule that gain and loss are not recognized when a foreign corporation makes a distribution of property in complete liquidation under section 332 to a foreign corporation that meets the stock ownership requirements of section 332(b) with respect to stock in the foreign liquidating corporation. Paragraph (c)(2) of this section provides the only exceptions to the nonrecognition rule of paragraph (c)(1) of this section. Paragraph (c)(3) of this section refers to other consequences of distributions described in paragraphs (c)(1) and (2) of this section. Paragraph (d) of this section contains an anti-abuse rule. Paragraph (e) of this section provides rules regarding failures to file statements or other documents required under this section or failures to comply with the requirements of this section. Paragraph (f) of this section provides relief for certain failures to file or comply. Finally, paragraph (g) of this section specifies the effective/applicability dates for the rules of this section. The rules of this section are issued pursuant to the authority conferred by section 367(e)(2).

(2) *Nonapplicability of section 367(a).* Section 367(a) shall not apply to a complete liquidation described in section 332 by a domestic liquidating corporation into a foreign corporation that meets the stock ownership requirements of section 332(b).

(b) *Distribution by a domestic corporation*—(1) *General rule*—(i) *Recognition of gain and loss.* If a domestic corporation (domestic liquidating corporation) makes a distribution of property in complete liquidation under section 332 to a foreign corporation (foreign distributee corporation) that meets the stock ownership requirements of section 332(b) with respect to stock in the

domestic liquidating corporation, then—

(A) Section 337(a) and (b)(1) will not apply; and

(B) The domestic liquidating corporation will recognize gain or loss on the distribution of property to the foreign distributee corporation, except as provided in paragraph (b)(2) of this section.

(ii) *Operating rules*—(A) *General rule.* Except as provided in paragraphs (b)(1)(ii) (B) and (C) of this section, the rules contained in section 336 will apply to the gain and loss recognized pursuant to this section.

(B) *Overall loss limitation*—(*1*) *Overall loss limitation rule.* Loss in excess of gain from the distribution shall not be recognized. If realized losses exceed recognized losses, the losses shall be recognized on a pro rata basis with respect to the realized loss attributable to each distributed loss asset in the category of assets (i.e., capital or ordinary) to which the realized but unrecognized loss relates. For additional limitations on the recognition of losses, see, e.g., section 1211.

(*2*) *Example.* The following example illustrates the overall loss limitation rule, the pro rata loss allocation method, and the general capital loss limitation rule in section 1211(a):

Example. F, a foreign corporation, owns all stock of US1, a domestic corporation. US1 owns the following capital assets: Asset A, which has a fair market value of $100 and an adjusted basis of $40; Asset B, which has a fair market value of $60 and an adjusted basis of $80; and, Asset C, which has a fair market value of $40 and an adjusted basis of $100. US1 also owns the following business assets that will generate ordinary income (or loss) upon disposition: Asset D, which has a fair market value of $100 and an adjusted basis of $40; Asset E, which has a fair market value of $60 and an adjusted basis of $100; and, Asset F, which has a fair market value of $40 and an adjusted basis of $80. US1 liquidates into F and distributes all assets to F in liquidation. None of the assets qualify for nonrecognition under paragraph (b)(2) of this section. US1's total realized capital loss is $80, but it may only recognize $60 of that loss. See section 1211(a). US1's total realized ordinary loss is $80, but it may only recognize $60 of that loss. See paragraph (b)(1)(ii)(B)(*1*) of this section. US1 will allocate $15 ($60 \times .25$) of the recognized capital loss to Asset B and will allocate the remaining $45 ($60 \times .75$) of recognized capital loss to Asset C. See paragraph (b)(1)(ii)(B)(*1*) of this section. US1 will allocate $30 ($60 \times .50$) of the recognized ordinary loss to Asset E and will allocate the remaining $30 ($60 \times .50$) to Asset F. See paragraph (b)(1)(ii)(B)(*1*) of this section.

(C) *Special rules for built-in gains and losses attributable to property received in liquidations and reorganizations.* Built-in losses attributable to property received in a transaction described in sections 332 or 361 (during the two-year period ending on the date of the distribution in liquidation covered by this section) shall not offset gain from property not received in the same transaction. Built-in gains attributable to property received in a transaction described in sections 332 or 361 (during the two-year period ending on the date of the distribution in liquidation covered by this section) shall not be offset by a loss from property not received in the same transaction. Built-in gain or loss is that amount of gain or loss on property that existed at the time the domestic liquidating corporation acquired such property. See sections 336(d) and 382 for additional limitations on the recognition of losses.

(iii) *Distribution of partnership interest*—(A) *General rule.* If a domestic corporation distributes a partnership interest (whether foreign or domestic) in a distribution described in paragraph (b)(1)(i) of this section, then for purposes of applying this section the domestic liquidating corporation shall be treated as having distributed a proportionate share of partnership property. Accordingly, the applicability of the recognition rules of paragraphs (b)(1)(i) and (ii) of this section, and of any exception to recognition provided in this section shall be determined with reference to the partnership property, rather than to the partnership interest itself. Where the partnership property includes an interest in a lower-tier partnership, the applicability of any exception with respect to the interest in the lower-tier partnership shall be determined with reference to the lower-tier partnership property. In the case of multiple tiers of partnerships, the applicability of an exception shall be determined with reference to the property of each partnership, applying the rule contained in the preceding

sentence. A domestic liquidating corporation's proportionate share of partnership property shall be determined under the rules and principles of sections 701 through 761 and the regulations thereunder.

(B) *Gain or loss calculation.* [Reserved]

(C) *Basis adjustments.* The foreign distributee corporation's basis in the distributed partnership interest shall be equal to the domestic liquidating corporation's basis in such partnership interest immediately prior to the distribution, increased by the amount of gain and reduced by the amount of loss recognized by the domestic liquidating corporation on the distribution of the partnership interest. Solely for purposes of sections 743 and 754, the foreign distributee corporation shall be treated as having purchased the partnership interest for an amount equal to the foreign corporation's adjusted basis therein.

(D) *Publicly traded partnerships.* The distribution by a domestic liquidating corporation of an interest in a publicly traded partnership that is treated as a corporation for U.S. income tax purposes under section 7704(a) shall not be subject to the rules of paragraphs (b)(1)(iii) (A) and (B) of this section. Instead, the distribution of such an interest shall be treated in the same manner as a distribution of stock. Thus, a transfer of an interest in a publicly traded partnership that is treated as a U.S. corporation for U.S. income tax purposes shall be treated in the same manner as stock in a domestic corporation, and a transfer of an interest in a publicly traded partnership that is treated as a foreign corporation for U.S. income tax purposes shall be treated in the same manner as stock in a foreign corporation.

(2) *Exceptions*—(i) *Distribution of property used in a U.S. trade or business*—(A) *Conditions for nonrecognition.* A domestic liquidating corporation shall not recognize gain or loss under paragraph (b)(1) of this section on its distribution of property (including inventory) used by the domestic liquidating corporation in the conduct of a trade or business within United States, if—

(*1*) The foreign distributee corporation, immediately thereafter and for the ten-year period beginning on the date of the distribution of such property, uses the property in the conduct of a trade or business within the United States;

(*2*) The domestic liquidating corporation attaches the statement described in paragraph (b)(2)(i)(C) of this section to its timely filed U.S. income tax returns for the taxable years that include the distributions in liquidation; and

(*3*) The foreign distributee corporation attaches a copy of the property description contained in paragraph (b)(2)(i)(C)(*2*) of this section to its timely filed U.S. income tax returns for the tax year that includes the date of distribution.

(B) *Qualifying property.* Property is used by the foreign distributee corporation in the conduct of a trade or business in the United States within the meaning of this paragraph (b)(2)(i) only if all income from the use of the property and all income or gain from the sale or exchange of the property would be subject to taxation under section 882(a) as effectively connected income. Also, stock held by a dealer as inventory or for sale in the ordinary course of its trade or business shall be treated as inventory and not as stock in the hands of both the domestic liquidating corporation and the distributee foreign corporation. Notwithstanding the foregoing, the exception provided in this paragraph (b)(2)(i) shall not apply to intangibles described in section 936(h)(3)(B).

(C) *Required statement.* The statement required by paragraph (b)(2)(i)(A) of this section shall be entitled ''Required Statement under §1.367(e)–2(b)(2)(i)'' and shall be prepared by the domestic liquidating corporation and signed under penalties of perjury by an authorized officer of the domestic liquidating corporation and by an authorized officer of the foreign distributee corporation. The statement shall contain the following items:

(*1*) A declaration that the distribution to the foreign distributee corporation is one to which the rules of this paragraph (b)(2)(i) apply and a certification that the domestic liquidating corporation and the foreign distributee corporation agree to comply with all the conditions and requirements of this

section, including, as provided in paragraph (e)(4)(ii)(B) of this section, to treat a failure to comply (as described in paragraph (e)(4)(i) of this section) as extending the period of limitations on assessment of tax for the taxable year in which gain is required to be reported.

(*2*) *Property description.* A description of all property distributed by the domestic liquidating corporation (irrespective of whether the property qualifies for nonrecognition). Such description shall be entitled ''Master Property Description'' and shall identify the property that continues to be used by the foreign distributee corporation in the conduct of a trade or business within the United States, including the location, adjusted basis, estimated fair market value, a summary of the method (including appraisals if any) used for determining such value, and the date of distribution of such items of property. The description shall also identify the property excepted from gain recognition under paragraphs (b)(2)(ii) and (iii) of this section.

(*3*) *Distributee identification.* An identification of the foreign distributee corporation, including its name and address, taxpayer identification number, residence, and place of incorporation.

(*4*) *Treaty benefits waiver.* With respect to property entitled to nonrecognition pursuant to this paragraph (b)(2)(i), a declaration by the foreign distributee corporation that it irrevocably waives any right under any treaty (whether or not currently in force at the time of the liquidation) to sell or exchange any item of such property without U.S. income taxation or at a reduced rate of taxation, or to derive income from the use of any item of such property without U.S. income taxation or at a reduced rate of taxation.

(*5*) *Statute of limitations extension.* An agreement by the domestic liquidating corporation and the foreign distributee corporation to extend the statute of limitations on assessments and collections (under section 6501) with respect to the domestic liquidating corporation on the distribution of each item of property until three years after the date on which all such items of property have ceased to be used in a trade or business within the United States, but in no event shall the extension be for a period longer than 13 years from the filing of the original U.S. income tax return for the taxable year of the last distribution of any such item of property. The agreement to extend the statute of limitation shall be executed on a Form 8838, ''Consent to Extend the Time to Assess Tax Under Section 367—Gain Recognition Agreement.''

(D) *Failure to file statement.* If a domestic liquidating corporation that would otherwise qualify for nonrecognition on the distribution of property under this paragraph (b)(2)(i) fails to file the statement described in paragraph (b)(2)(i)(C) of this section or files a statement that does not comply with the requirements of paragraph (b)(2)(i)(C) of this section, the Commissioner may treat the domestic liquidating corporation as if it had claimed nonrecognition under this paragraph (b)(2)(i) and met all the requirements of paragraph (b)(2)(i)(C) of this section, if such treatment is necessary to prevent the domestic liquidating corporation or the foreign distributee corporation from otherwise deriving a tax benefit by such failure.

(E) *Operating rules.* By the domestic liquidating corporation's claiming nonrecognition under this paragraph (b)(2)(i) and filing a statement described in paragraph (b)(2)(i)(C) of this section, the domestic liquidating corporation and the foreign distributee corporation agree to be subject to the rules of this paragraph (b)(2)(i)(E).

(*1*) *Gain or loss recognition by the foreign distributee corporation—*(*i*) *Taxable dispositions.* If, within the ten-year period from the date of a distribution of qualifying property, the foreign distributee corporation disposes of any qualifying property in a transaction subject to tax under section 882(a), then the foreign distributee corporation shall recognize such gain (or loss) and properly report it on a timely filed U.S. income tax return. If the foreign distributee corporation recognizes gain (or loss) under this paragraph (b)(2)(i)(E)(*1*)(*i*) and properly reports such gain (or loss) on its U.S. income tax return, then the domestic liquidating corporation shall not recognize gain attributable to such property

under paragraph (b)(2)(i)(E)(*2*) of this section.

(*ii*) *Other triggering events.* If, within the ten-year period from the date of distribution, any qualifying property ceases to be used by the foreign distributee corporation in the conduct of a trade or business in the United States (other than by reason of a taxable disposition described in paragraph (b)(2)(i)(E)(*1*)(*i*) of this section, a nontriggering event described in paragraph (b)(2)(i)(E)(*4*) of this section, or a nontriggering transfer described in paragraph (b)(2)(i)(E)(*5*) of this section), then the foreign distributee corporation shall recognize gain (but not loss) attributable to such property and properly report it on a timely filed U.S. income tax return. If the foreign distributee corporation properly reports gain under this paragraph (or if such qualified property is not gain property on the date that it ceases to be used in the foreign distributee corporation's U.S. trade or business), then the domestic liquidating corporation shall not recognize gain attributable to such property under paragraph (b)(2)(i)(E)(*2*) of this section. The gain recognized under this paragraph (b)(2)(i)(E)(*1*)(*ii*) shall be an amount equal to the fair market value of the property on the date it ceases to be used in the foreign distributee corporation's U.S. trade or business less the foreign distributee corporation's adjusted basis in such property.

(*2*) *Gain recognition by the domestic liquidating corporation—*(*i*) *General rule.* If, within the ten-year period from the date of distribution, any qualifying property described in paragraph (b)(2)(i)(B) of this section ceases to be used by the foreign distributee corporation (or a qualifying transferee described in paragraph (b)(2)(i)(E)(*5*) of this section) in the conduct of a trade or business in the United States for any reason (including but not limited to the sale or exchange of such property or the removal of the property from conduct of the trade or business), then, except to the extent gain (or loss) is recognized under paragraph (b)(1)(i)(E)(*1*) of this section, the domestic liquidating corporation shall recognize the gain (but not loss) realized but not recognized upon the initial distribution of such item of property. The domestic liquidating corporation shall recognize gain pursuant to this paragraph (b)(2)(i)(E)(*2*)(*i*) on the amended U.S. income tax return described in paragraph (b)(2)(i)(E)(*2*)(*ii*) of this section.

(*ii*) *Amended return.* If gain recognition is required pursuant to paragraph (b)(2)(i)(E)(*2*)(*i*) of this section, the foreign distributee corporation shall file an amended U.S. income tax return on behalf of the domestic liquidating corporation for the year of the distribution of such item of property. On the amended return, the domestic liquidating corporation may use any losses (or credits) existing in the year of the distribution to offset the gain recognized pursuant to paragraph (b)(2)(i)(E)(*2*)(*i*) of this section (or the tax thereon), provided that the losses (or credits) were otherwise available in the year distribution and were not used in another year. The amended return shall be filed no later than the due date (including extensions) for the return of the foreign distributee corporation for the taxable year in which the property ceases to be used by the foreign distributee corporation in the conduct of a trade or business in the United States.

(*iii*) *Interest.* If the domestic liquidating corporation owes additional tax pursuant to paragraph (b)(2)(i)(E)(*2*)(*i*) of this section for the year of liquidation, then interest must be paid on that amount at the rates determined under section 6621. The interest due will be calculated from the due date of the domestic liquidating corporation's U.S. income tax return for the year of the distribution to the date on which the additional tax for that year is paid.

(*iv*) *Joint and several liability.* The foreign distributee corporation shall be jointly and severally liable for any tax owed by the domestic liquidating corporation as a result of the application of this section, and shall succeed to the domestic liquidating corporation's agreement to extend the statute of limitations on assessments and collections under section 6501.

(*3*) *Schedule for property no longer used in a U.S. trade or business.* If qualifying property (other than inventory) ceases to be used by the foreign distributee

corporation in the conduct of a U.S. trade or business in the ten-year period beginning on the date of distribution of such property from the domestic liquidating corporation to the foreign distributee corporation, then the foreign distributee corporation shall list on a separate schedule (attached to its timely filed U.S. income tax returnfor the year of cessation) all such qualifying property. For purposes of this paragraph (b)(2)(i)(E)(*3*), property ceases to be used in a U.S. trade or business whenever such property is sold, exchanged, or otherwise removed from the U.S. trade or business, irrespective of whether the domestic liquidating corporation filed an amended return under paragraph (b)(2)(i)(E)(*2*) of this section, and irrespective of whether the property ceases to be used in the foreign distributee corporation's U.S. trade or business by virtue of a nontriggering event described in paragraph (b)(2)(i)(E)(*4*) of this section or a nontriggering transfer described in paragraph (b)(2)(i)(E)(*5*) of this section.

(*4*) *Nontriggering events*—(*i*) *Conversions, certain exchanges, and abandonment.* Gain (or loss) under this paragraph (b)(2)(i)(E) shall not be triggered if qualifying property described in paragraph (b)(2)(i)(B) of this section is involuntarily converted into, or exchanged for, similar qualifying property used in the conduct of a trade or business in the United States, to the extent such conversion or exchange qualifies for nonrecognition under section 1033 or 1031. Also, the abandonment or disposal of worthless or obsolete property shall not trigger gain (or loss) under this paragraph (b)(2)(i)(E).

(*ii*) *Amendment to Master Property Description.* If the foreign distributee corporation acquires replacement property by virtue of a conversion or exchange of the qualifying property under this paragraph (b)(2)(i)(E)(*4*), then the foreign distributee corporation shall attach to its timely filed U.S. income tax return for the year of the acquisition such replacement property a schedule entitled ''Amendment to Master Property Description Required by §1.367(e)–2(b)(2)(i)'' that lists the replacement property and the property being replaced.

(*5*) *Nontriggering transfers to qualified transferees.* Gain (or loss) under this paragraph (b)(2)(i)(E) will not be triggered if qualifying property described in paragraph (b)(2)(i)(B) of this section is transferred to another person (qualified transferee) in a transaction qualifying for nonrecognition under the Internal Revenue Code (other than transactions described in paragraphs (b)(2)(i)(E)(4)(*i*) and (c)(1) of this section), if—

(*i*) The qualified transferee (and all other subsequent qualified transferees), immediately thereafter and for the ten-year period beginning on the date of the initial distribution of such qualifying property from the domestic liquidating corporation to the foreign distributee corporation, uses the property in the conduct of a trade or business in the United States;

(*ii*) The foreign distributee corporation (or its successor in interest) prepares and attaches to its timely filed U.S. income tax return for the year of transfer a statement entitled ''Required Statement under §1.367(e)–2(b)(2)(i)(E)(*5*) for Property Transferred to a Qualified Transferee'' that is signed under penalties of perjury by an authorized officer of the foreign distributee corporation and by a person similarly authorized by the qualified transferee;

(*iii*) The statement described in paragraph (b)(2)(i)(E)(*5*)(*ii*) of this section shall contain a description of all qualifying property transferred by the foreign distributee corporation (or qualified transferee) to the qualified transferee (or subsequent qualified transferee);

(*iv*) The statement described in paragraph (b)(2)(i)(E)(*5*)(*ii*) of this section shall also contain an identification of the qualified transferee (or subsequent qualified transferee), including its name and address, taxpayer identification number, residence, and place of incorporation (if applicable);

(*v*) The statement described in paragraph (b)(2)(i)(E)(*5*)(*ii*) of this section shall also contain a declaration by the qualifying transferee (or subsequent qualifying transferee) that it irrevocably waives any right under any treaty (whether or not currently in force at the time of the liquidation) to

sell or exchange any item of such property without U.S. income taxation or at a reduced rate of taxation, or to derive income from the use of any item of such qualifying property without U.S. income taxation or at a reduced rate of taxation; and

(*vi*) A declaration that the transfer to the qualifying transferee (or subsequent qualifying transferee) is one to which the rules of this paragraph (b)(2)(i)(E)(*5*) apply and a certification that the foreign distributee corporation (or its successor in interest) and the qualifying transferee (or subsequent qualifying transferee) agree to all of the terms and conditions set forth in paragraph (b)(2)(i)(E)(*1*) of this section, replacing ''foreign distributee corporation'' with ''qualifying transferee'' and replacing references to ''section 882(a)'' with ''section 871(b)'' (as the case may be).

(ii) *Distribution of certain U.S. real property interests.* A domestic liquidating corporation shall not recognize gain (or loss) under paragraph (b)(1) of this section on the distribution of a U.S. real property interest (other than stock in a former U.S. real property holding corporation that is treated as a U.S. real property interest for five years under section 897(c)(1)(A)(ii)). If property distributed by the domestic liquidating corporation is a U.S. real property interest that qualifies for nonrecognition under this paragraph (b)(2)(ii) in addition to nonrecognition provided by paragraph (b)(2)(i) of this section, then the domestic liquidating corporation shall secure nonrecognition pursuant to this paragraph (b)(2)(ii) and not pursuant to the provisions of paragraph (b)(2)(i) of this section.

(iii) *Distribution of stock of domestic subsidiary corporations*—(A) *Conditions for nonrecognition.* A domestic liquidating corporation shall not recognize gain or loss under paragraph (b)(1) of this section on a distribution of stock of an 80 percent domestic subsidiary corporation, if the domestic liquidating corporation attaches a statement described in paragraph (b)(2)(iii)(D) of this section to its timely filed U.S. income tax return for the year of the distribution of such stock. For purposes of this paragraph (b)(2)(iii), a corporation is an 80 percent domestic subsidiary corporation, if—

(*1*) The subsidiary corporation is a domestic corporation (but not a foreign corporation that has made an election under section 897(i) to be treated as a U.S. corporation for purposes of section 897);

(*2*) The domestic liquidating corporation owns (directly and without regard to paragraph (b)(1)(iii) of this section) at least 80 percent of the total voting power of the stock of such corporation; and

(*3*) The domestic liquidating corporation owns (directly and without regard to paragraph (b)(1)(iii) of this section) at least 80 percent of the total value of all stock of such corporation.

(B) *Exceptions when the liquidating corporation is a U.S. real property holding corporation.* If the domestic liquidating corporation is a U.S. real property holding corporation (as defined in section 897(c)(2)) at the time of liquidation (or is a former U.S. real property holding corporation the stock of which is treated as a U.S. real property interest for five years under section 897(c)(1)(A)(ii)), then the exception in paragraph (b)(2)(iii)(A) of this section shall apply only to the distribution of stock of an 80 percent domestic subsidiary corporation that is a U.S. real property holding corporation (as defined in section 897(c)(2)) at the time of the liquidation and immediately thereafter.

(C) *Anti-abuse rule.* (*1*) The exception in paragraph (b)(2)(iii)(A) of this section shall not apply, if a principal purpose of the distribution of the 80 percent domestic subsidiary corporation's stock is the avoidance of U.S. tax that would have been imposed on the domestic liquidating corporation's disposition of such stock when taken together to an unrelated party. A distribution may have a principal purpose of tax avoidance even though the tax avoidance purpose is outweighed by other purposes when taken together.

(*2*) For purposes of paragraph (b)(2)(iii)(C)(*1*) of this section, a distribution of stock of the 80 percent domestic subsidiary corporation will be deemed to have been made pursuant to a plan, one of the principal purposes of which was the avoidance of U.S. tax, if

the foreign distributee corporation disposes of (whether in a recognition or nonrecognition transaction) any such stock within two years of such distribution. The rule in this paragraph (b)(2)(iii)(C)(*2*) will not apply if the foreign distributee corporation can demonstrate to the satisfaction of the Commissioner that the avoidance of U.S. tax was not a principal purpose of the liquidation.

(D) *Required statement.* The statement required by paragraph (b)(2)(iii)(A) of this section shall be entitled ''Required Statement under §1.367(e)–2(b)(2)(iii) for Stock of 80 Percent Domestic Subsidiary Corporations'' and shall be prepared by the domestic liquidating corporation and shall be signed under penalties of perjury by an authorized officer of the domestic liquidating corporation and by an authorized officer of the foreign distributee corporation. The required statement shall contain a certification that states that if the foreign distributee corporation disposes of any stock subject to paragraph (b)(2)(iii)(A) of this section in a transaction described in paragraph (b)(2)(iii)(C) of this section, then the domestic liquidating corporation shall recognize all realized gain attributable to the distributed stock at the time of distribution, and the domestic liquidating corporation (or the foreign distributee corporation on behalf of the domestic liquidating corporation) shall file a U.S. income tax return (or amended U.S. income tax return, as the case may be) for the year of distribution reporting the gain attributable to such stock. The required statement shall also state that the domestic liquidating corporation agrees, as provided in paragraph (e)(4)(ii)(B) of this section, to treat a failure to comply (as described in paragraph (e)(4)(i) of this section) as extending the period of limitations on assessment of tax for the taxable year in which gain is required to be reported.

(3) *Other consequences*—(i) *Distributee basis in property.* The foreign distributee corporation's basis in property subject to this paragraph (b) shall be the same as the domestic liquidating corporation's basis in such property immediately before the liquidation, increased by any gain, or reduced by any loss recognized by the domestic liquidating corporation on such property pursuant to paragraph (b)(1) of this section.

(ii) *Reporting under section 6038B.* Section 6038B and the regulations thereunder apply to a domestic liquidating corporation's transfer of property to a foreign distributee corporation under section 367(e)(2).

(iii) *Other rules.* For other rules that may be applicable, see sections 1248, 897, and 381.

(c) *Distribution by a foreign corporation*—(1) *General rule—gain and loss not recognized.* If a foreign corporation (foreign liquidating) makes a distribution of property in complete liquidation under section 332 to a foreign corporation (foreign distributee) that meets the stock ownership requirements of section 332(b) with respect to stock in the foreign liquidating corporation, then, except as provided in paragraph (c)(2) of this section, section 337 (a) and (b)(1) shall apply and the foreign liquidating corporation shall not recognize gain (or loss) on the distribution under section 367(e)(2). If a foreign liquidating corporation distributes a partnership interest (whether foreign or domestic), then such corporation shall be treated as having distributed a proportionate share of partnership property in accordance with the principles of paragraph (b)(1)(iii) of this section.

(2) *Exceptions*—(i) *Property used in a U.S. trade or business*—(A) *General rule.* A foreign liquidating corporation (including a corporation that has made an effective election under section 897(i)) that makes a distribution described in paragraph (c)(1) of this section shall recognize gain (or loss in accordance with principles contained in paragraph (b)(1)(ii) of this section) on the distribution of qualified property, as described in paragraph (b)(2)(i)(B) of this section (other than U.S. real property interests), that is used by the foreign liquidating corporation in the conduct of a trade or business within the United States at the time of distribution.

(B) *Ten-year active U.S. business exception.* A foreign liquidating corporation shall not recognize gain under paragraph (c)(2)(i)(A) of this section, if—

(*1*) The foreign distributee corporation, immediately thereafter and for the ten-year period beginning on the date of the distribution of such property, uses the property in the conduct of a trade or business in the United States;

(*2*) The foreign distributee corporation is not entitled to benefits under a comprehensive income tax treaty (this requirement shall apply only if the foreign liquidating corporation (or predecessor corporation) was not entitled to benefits under a comprehensive income tax treaty); and

(*3*) The foreign liquidating corporation and foreign distributee corporation attach the statement described in paragraph (c)(2)(i)(C) of this section to their timely filed U.S. income tax returnsfor their taxable years that include the distribution.

(C) *Required statement.* The statement required by paragraph (c)(2)(i)(B)(3) of this section shall be entitled ''Required Statement under §1.367(e)–2(c)(2)(i),'' shall be prepared by foreign liquidating corporation, shall be signed under penalties of perjury by an authorized officer of the foreign liquidating corporation and by an authorized officer of the foreign distributee corporation, and shall be identical to the statement described in paragraph (b)(2)(i)(C) of this section, except that ''§1.367(e)–2(c)(2)(i)(B)'' shall be substituted for references to ''§1.367(e)–2(b)(2)(i)'' and ''foreign liquidating corporation'' shall be substituted for ''domestic liquidating corporation'' each time it appears. References in the rules of paragraph (b)(2)(i)(C) of this section to various rules in paragraph (b) of this section shall be applied as if such references were to this paragraph (c). However, the statement described in this paragraph (c)(2)(i)(C) shall be modified as follows:

(*1*) The foreign distributee corporation shall not be required to waive its income tax treaty benefits as required by §1.367(e)–2(b)(2)(i)(C)(*4*), unless—

(*i*) The foreign liquidating corporation was required to waive its treaty benefits under paragraph (b)(2)(i)(C)(4) of this section in connection with the distribution of such property in a prior liquidation distribution subject to the provisions of this section; or (*ii*) The foreign distributee corporation is entitled benefits under a treaty to which the foreign liquidating corporation was not entitled.

(*2*) If the foreign distributee is required to waive treaty benefits because of paragraph (c)(2)(i)(C)(*1*)(*ii*) of this section, then the foreign distributee shall only be required to waive benefits that were not available to the foreign liquidating corporation (or a predecessor corporation) prior to liquidation.

(*3*) The property description described in paragraph (b)(2)(i)(C)(*2*) of this section shall include only the qualified U.S. trade or business property described in paragraph (c)(2)(i) of this section.

(D) *Operating rules.* By the foreign liquidating corporation's claiming nonrecognition under paragraph (c)(2)(i)(B) of this section and filing a statement described in paragraph (c)(2)(i)(C) of this section, the foreign liquidating corporation and the foreign distributee corporation agree to be subject to the rules of paragraph (c)(2)(i) of this section, as well as the rules of paragraphs (b)(2)(i)(D) and (E) of this section. In applying the rules of paragraphs (b)(2)(i)(D) and (E) of this section, ''foreign liquidating corporation'' shall be used instead of ''domestic liquidating corporation'' each time it appears. References in the rules of paragraphs (b)(2)(i)(D) and (E) of this section to various rules in paragraph (b) of this section shall be applied as if such references were to this paragraph (c).

(ii) *Property formerly used in a United States trade or business.* A foreign liquidating corporation that makes a distribution described in paragraph (c)(1) of this section shall recognize gain (but not loss) on the distribution of property (other than U.S. real property interests) that had ceased to be used by the foreign liquidating corporation in the conduct of a U.S. trade or business within the ten-year period ending on the date of distribution and that would have been subject to section 864(c)(7) had it been disposed. Section 864(c)(7) shall govern the treatment of any gain recognized on the distribution of assets described in this paragraph as income effectively connected with the conduct

of a trade or business within the United States.

(3) *Other consequences*—(i) *Distributee basis in property*. The foreign distributee corporation's basis in property subject to this paragraph (c) shall be the same as the foreign liquidating corporation's basis in such property immediately before the liquidation, increased by any gain, or reduced by any loss recognized by the foreign liquidating corporation on such property, pursuant to paragraph (c)(2) of this section.

(ii) *Other rules*. For other rules that may apply, see sections 367(b) and 381.

(d) *Anti-abuse rule*. The Commissioner may require a domestic liquidating corporation to recognize gain on a distribution in liquidation described in paragraph (b) of this section (or treat the liquidating corporation as if it had recognized loss on a distribution in liquidation), if a principal purpose of the liquidation is the avoidance of U.S. tax (including, but not limited to, the distribution of a liquidating corporation's earnings and profits with a principal purpose of avoiding U.S. tax). A liquidation may have a principal purpose of tax avoidance even though the tax avoidance purpose is outweighed by other purposes when taken together.

(e) *Failures to file or failures to comply*—(1) *Scope*. This paragraph (e) provides rules regarding a failure to file an initial liquidation document with respect to one or more liquidating distributions by a domestic liquidating corporation that, absent such failure, would qualify for nonrecognition treatment under paragraph (b)(2)(i) or (iii) of this section, or with respect to one or more liquidating distributions by a foreign liquidating corporation that, absent such failure, would qualify for nonrecognition treatment under paragraph (c)(2)(i)(B) of this section (failure to file). This paragraph (e) also provides rules regarding failures to comply in all material respects with the terms of this section with respect to one or more liquidating distributions for which nonrecognition treatment was initially claimed under paragraph (b)(2)(i), (b)(2)(iii), or (c)(2)(i)(B) of this section, as applicable (failure to comply).

(2) *Definitions*. The following definitions apply for purposes of this section.

(i) An *initial liquidation document* means any statement, schedule, or form required to be filed under this section in order for the domestic liquidating corporation or foreign liquidating corporation, as applicable, to initially qualify to claim nonrecognition treatment with respect to one or more liquidating distributions described in this section, including—

(A) The statement and attachments described in paragraph (b)(2)(i)(C) of this section;

(B) The statement described in paragraph (b)(2)(iii)(D) of this section; and

(C) The statement and attachments described in paragraph (c)(2)(i)(C) of this section.

(ii) A *subsequent liquidation document* means any statement, schedule, or form (other than an initial liquidation document) required to be filed under this section in order for the domestic liquidating corporation or foreign liquidating corporation, as applicable, to continue to qualify for nonrecognition treatment with respect to one or more liquidating distributions described in this section, including—

(A) The schedule described in paragraph (b)(2)(i)(E)(*3*) of this section;

(B) The schedule described in paragraph (b)(2)(i)(E)(*4*)(*ii*) of this section; and

(C) The statement and attachments described in paragraph (b)(2)(i)(E)(*5*) of this section.

(iii) A *timely filed U.S. income tax return* means a Federal income tax return filed on or before the last date prescribed for filing (taking into account any extensions of time therefor) such return.

(3) *Failure to file*—(i) *General rule*. For purposes of this section and except as provided in paragraph (b)(2)(i)(D) or (f) of this section, there is a failure to file an initial liquidation document if—

(A) An initial liquidation document is not filed with the timely filed U.S. income tax return specified under this section, or

(B) An initial liquidation document is not completed in all material respects.

(ii) *Consequences of a failure to file.* If there is a failure to file an initial liquidation document, then nonrecognition treatment under paragraph (b)(2)(i), (b)(2)(iii), or (c)(2)(i)(B) of this section (as appropriate) will not apply.

(4) *Failure to comply*—(i) *General rule.* For purposes of this section and except as provided in paragraph (b)(2)(i)(D) or (f) of this section, a failure to comply includes—

(A) A failure to report gain, or pay any additional tax or interest due, in accordance with the requirements under this section; and

(B) A failure to file a subsequent liquidation document, as determined by applying paragraph (e)(3)(i) of this section, but replacing the term ''initial liquidation document'' with the term ''subsequent liquidation document.''

(ii) *Consequences of a failure to comply.* If there is a failure to comply in any material respect with the terms of paragraph (b)(2)(i), (b)(2)(iii), or (c)(2)(i) of this section, as applicable, then—

(A) Any gain (but not loss) that was not previously recognized by the domestic liquidating corporation or foreign liquidating corporation, as applicable, under paragraph (b)(2)(i), (b)(2)(iii), or (c)(2)(i)(B) of this section must be recognized; and

(B) The period of limitations on assessment of tax for the taxable year in which gain is required to be reported will be extended until the close of the third full taxable year ending after the date on which the domestic liquidating corporation, foreign distributee corporation, or foreign liquidating corporation, as applicable, furnishes to the Director of Field Operations International, Large Business & International (or any successor to the roles and responsibilities of such position, as appropriate) (Director) the information that should have been provided under this section.

(f) *Relief for certain failures to file or failures to comply that are not willful*—(1) *In general.* This paragraph (f) provides relief if there is a failure to file an initial liquidation document as described in paragraph (e)(3)(i) of this section (failure to file), or a failure to comply in any material respect with the terms of this section as described in paragraph (e)(4)(i) of this section (failure to comply). A failure to file or a failure to comply will be deemed not to have occurred for purposes of paragraph (e)(3)(ii) or (e)(4)(ii) of this section if the taxpayer demonstrates that the failure was not willful using the procedure set forth in this paragraph (f). For this purpose, willful is to be interpreted consistent with the meaning of that term in the context of other civil penalties, which would include a failure due to gross negligence, reckless disregard, or willful neglect. Whether a failure to file or failure to comply was willful will be determined by the Director (as described in paragraph (e)(4)(ii)(B) of this section) based on all the facts and circumstances. The taxpayer must submit a request for relief and an explanation as provided in paragraph (f)(2)(i) of this section. Although a taxpayer whose failure to file or failure to comply is determined not to be willful will not be subject to gain or loss recognition under this section, the taxpayer will be subject to a penalty under section 6038B if the taxpayer fails to satisfy the reporting requirements, if any, under that section and does not demonstrate that the failure was due to reasonable cause and not willful neglect. See §1.6038B–1(e)(4) and (f). The determination of whether the failure to file or failure to comply was willful under this section has no effect on any request for relief made under §1.6038B–1(f).

(2) *Procedures for establishing that a failure to file or failure to comply was not willful*—(i) *Time and manner of submission.* A taxpayer's statement that a failure to file or failure to comply was not willful will be considered only if, promptly after the taxpayer becomes aware of the failure, an amended return is filed for the taxable year to which the failure relates that includes the information that should have been included with the original return for such taxable year or that otherwise complies with the rules of this section, and that includes a written statement explaining the reasons for the failure. In the case of a liquidating distribution described in paragraph (b)(2)(iii) of this section, the taxpayer must file, with the amended return, a Form 8838 extending the period of limitations on assessment of tax with respect to the

gain realized but not recognized with respect to the liquidating distribution to the close of the third full taxable year ending after the date on which the required information is provided to the Director. In the case of a liquidating distribution described in paragraph (b)(2)(i) or (c)(2)(i)(B) of this section, the taxpayer must file, with the amended return, a Form 8838 extending the period of limitations on the assessment of tax with respect to the gain realized but not recognized with respect to the liquidating distribution to the later of: the date provided in paragraph (b)(2)(i)(C)(*5*), taking into account paragraph (c)(2)(i)(C) and (D), as applicable (date one); or, the close of the third full taxable year ending after the date on which the required information is provided to the Director (date two). However, the taxpayer is not required to file a Form 8838 with the amended return if both date one is later than date two and a Form 8838 was previously filed extending the period of limitations on assessment of tax with respect to the gain realized but not recognized with respect to the liquidating distribution to date one. If a Form 8838 is not required to be filed pursuant to the previous sentence, a copy of the previously filed Form 8838 must be filed with the amended return. The amended return and either a Form 8838 or a copy of the previously filed Form 8838, as the case may be, must be filed with the Internal Revenue Service at the location where the taxpayer filed its original return. The taxpayer may submit a request for relief from the penalty under section 6038B as part of the same submission. See §1.6038B–1(f).

(ii) *Notice requirement.* In addition to the requirements of paragraph (f)(2)(i) of this section, the taxpayer must comply with the notice requirements of this paragraph (f)(2)(ii). If any taxable year of the taxpayer is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Internal Revenue Service personnel conducting the examination. If no taxable year of the taxpayer is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Director.

(3) For illustrations of the application of the willfulness standard of this paragraph (f), see the examples in §1.367(a)–8(p)(3).

(g) *Effective/applicability dates.* Except as otherwise provided, this section applies to distributions occurring on or after September 7, 1999 or, if the taxpayer so elects, to distributions in taxable years ending after August 8, 1999. The ninth, tenth, and eleventh sentences of paragraph (a) of this section, and paragraphs (b)(1)(i), (b)(2)(i)(A)(*2*), (b)(2)(i)(A)(*3*), (b)(2)(i)(E)(*3*), (b)(2)(i)(E)(*4*)(*ii*), (b)(2)(i)(E)(*5*)(*ii*), (b)(2)(iii)(A), (c)(2)(i)(B)(*3*), (e), and (f) of this section will apply to liquidation documents that are required to be filed on or after November 19, 2014, as well as to requests for relief submitted on or after November 19, 2014.

[T.D. 8834, 64 FR 43077, Aug. 9, 1999; 65 FR 11467, Mar. 3, 2000, as amended by T.D. 9066, 68 FR 39452, July 2, 2003; T.D. 9704, 79 FR 68771, Nov. 19, 2014; 80 FR 167, Jan. 5, 2015]

SPECIAL RULE; DEFINITIONS

§ 1.368–1 Purpose and scope of exception of reorganization exchanges.

(a) *Reorganizations.* As used in the regulations under parts I, II, and III (section 301 and following), subchapter C, chapter 1 of the Code, the terms *reorganization* and *party to a reorganization* mean only a reorganization or a party to a reorganization as defined in subsections (a) and (b) of section 368. In determining whether a transaction qualifies as a reorganization under section 368(a), the transaction must be evaluated under relevant provisions of law, including the step transaction doctrine. But see §§1.368–2 (f) and (k) and 1.338–3(d). The preceding two sentences apply to transactions occurring after January 28, 1998, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding on January 28, 1998, and at all times thereafter. With respect to insolvency reorganizations, see part IV, subchapter C, chapter 1 of the Code.

(b) *Purpose.* Under the general rule, upon the exchange of property, gain or loss must be accounted for if the new